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No. ....-....

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In the Supreme Court
OF THE
United States

OCTOBER TERM, 1985

TENNECO WEST, INC., a Delaware corporation,
Petitioner,

vs.

MARATHON OIL COMPANY, an Ohio corporation.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

1. Whether the Crude Oil Windfall Profit Tax is a tax on income or profits or an excise or severance tax on the production of oil.

2. Whether the United States Court of Appeals for the Ninth Circuit erred in determining the Crude Oil Windfall Profit Tax to be a tax on income or profits by considering only the tax's descriptive language while ignoring the relevant legislative history, failing to examine the tax's intended and actual operation, and holding itself bound by a state appellate court's erroneous interpretation of the tax.

3. Whether the burden of the Crude Oil Windfall Profit Tax falls, under the tax-shifting clauses of the oil and gas leases in question, upon the operator-lessee rather than the owner-lessor as a tax upon or referable to any operations or acts of the lessee upon the premises.

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PETITION FOR WRIT OF CERTIORARI

OPINIONS BELOW

The opinion of the district court is reported at *Tenneco West, Inc. v. Marathon Oil Co.*, 564 F.Supp. 381 (C.D.Cal. 1983), *rev'd*, 756 F.2d 769 (9th Cir. 1985), a copy of which is appended hereto as Appendix A.

The opinion of the court of appeals is reported at *Tenneco West, Inc. v. Marathon Oil Co.*, 756 F.2d 769 (9th Cir. 1985), a copy of which is appended hereto as Appendix B.

JURISDICTION

The decision sought to be reviewed was made and entered on March 29, 1985 by the United States Court of Appeals for the Ninth Circuit. No rehearing or extension

of time to petition for certiorari has been sought. The statutory provision that confers jurisdiction on this Court to review the judgment in question is 28 U.S.C. § 1254(1).

STATUTES INVOLVED

This case involves the following sections of the Crude Oil Windfall Profit Tax Act: 26 U.S.C. §§ 4986, 4987, 4988, 4989, and 4996, a copy of which is appended hereto as Appendix C.

REASONS FOR GRANTING THE WRIT

The decision of the Ninth Circuit has far reaching implications that will significantly affect not only the parties to this case, but also numerous other corporations, individuals and the United States Treasury. Essentially, the Ninth Circuit erroneously construed the nature of the Crude Oil Windfall Profit Tax to be an income or profits tax rather than an excise or severance tax on production. In so doing, the Ninth Circuit utterly ignored the language and intent of the statute, the relevant legislative history, and the operation of the tax. In reaching its decision, the Ninth Circuit inexplicably assumed that it was bound by a state appellate court decision on the federal question involved and blatantly refused to follow this Court's mandate that the nature of a tax must be determined by its operation, not its descriptive language or title.

If left uncorrected, the decision will result in the unintended transfer of possibly hundreds of millions of dollars of oil production revenue. That transfer will adversely impact the Treasury of the United States, by virtue of the Mineral Lands Leasing Act, 30 U.S.C. §§ 181

et seq.,[1] as well as individual royalty owners and the entire oil industry. Further, the decision portends the untenable situation of inevitable direct conflicts among the United States Circuit Courts of Appeals. Tenneco therefore respectfully submits that to avoid a conflict among the circuits, to prevent the enormous loss of revenue to the United States and its citizens, and to avert the substantial miscarriage of justice through the misinterpretation and misapplication of an important federal statute, this Court should grant this petition and definitively resolve the issue of the nature of the Crude Oil Windfall Profit Tax.

STATEMENT OF THE CASE

During the 1930's, the predecessor of Tenneco West, Inc. ("Tenneco") leased certain oil and gas tracts in Kern County, California to Marathon Oil Company ("Marathon"). The three leases at issue in this case[2] contain provisions that shift the burden for certain taxes to Marathon, the lessee, in language substantially identical to the following "tax shift" clause:

> TAXES, ASSESSMENT, ETC. ON ACCOUNT OF OPERATIONS, ETC. The Lessee shall, at its own expense, and without reimbursement by the Lessor, *pay and discharge any and all taxes*, charges or

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[1] *See New Mexico v. Regan*, 745 F.2d 1318 (10th Cir. 1984) (transferred to Ct.Cl.), *cert. denied*, 105 S.Ct. 2138 (1985).

[2] When Tenneco first commenced this action in district court, it sought recovery on all four of its leases with Marathon, one of which does not contain the tax shift clause. The district court found in Tenneco's favor only as to those three leases that do contain the clause. When Marathon appealed the district court's decision as to the three leases, Tenneco did not cross-appeal as to the fourth lease. Accordingly, all leases that are the subject of this petition contain the tax shift clause.

> assessments *upon or referable to any operations or acts of the Lessee* or on its behalf upon the demised premises, including (but not by such inclusion limiting the generality of the foregoing) the drilling or operation of any well or wells, the production, extraction, severance or removal of any oil or other products, the processing, refining, storage or use thereof, the sale of any such oil or other products or of any products manufactured therefrom or therewith, or the transportation thereof away from the demised premises ....

Tenneco West, Inc. v. Marathon Oil Co., 564 F.Supp. 381, 382-83 (C.D.Cal. 1983) (emphasis added), *rev'd*, 756 F.2d 769 (9th Cir. 1985).

When these leases and numerous others containing identical language were executed, no federal or state taxes on "production, extraction, severance or removal" existed. On March 1, 1980, however, the Crude Oil Windfall Profit Tax Act ("Act"), 26 U.S.C. §§ 4986 *et seq.*, imposed a tax ("Tax") on the initial producer of crude oil at the time the oil is removed from the premises: "An excise tax is hereby imposed on the windfall profit from taxable crude oil removed from the premises during each taxable period." *Id.* § 4986(a). Significantly, imposition of the Tax does not depend upon the sale of the oil or the realization of any income or profit from its disposition. Rather, liability for the Tax attaches upon removal of the oil from the premises whether the oil is sold, refined, lost or destroyed. *Id.* §§ 4986, 4988(c). In short, the Tax is not in any way based upon, applied to, or measured by income or profits.

The Tax's ambiguous "windfall profit" label is easily clarified by reference to the legislative history, which establishes that the tax is not a tax on income or profits, but a *specific type* of excise tax, namely a *severance* tax on

domestic crude oil production imposed at the wellhead upon removal.[3] This characterization of the Tax is overwhelmingly endorsed by commentators.[4]

Accordingly, the Tax falls squarely within the provisions of the tax shift clause, and Marathon alone is obligated to pay the Tax. Yet, Marathon has persisted in withholding the Tax from its royalty payments to Tenneco.[5]

On March 25, 1982, Tenneco commenced this action against Marathon in district court seeking declaratory relief on the basis of diversity jurisdiction under 28 U.S.C. § 1332. On June 10, 1983, upon cross-motions for summary judgment, the district court ruled that Marathon must bear the entire burden of the Tax as to those leases containing the tax shift clause. *Tenneco West, Inc. v.*

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[3]According to the House of Representatives Report: "The Windfall Profit Tax is an excise, or *severance tax*. . . . Taxing excess oil revenues through an excise tax is a far simpler approach to taxing windfall profits than an excess profit tax, such as was used during World War II and the Korean War." H.R. Rep. No. 304, 96th Cong., 2d Sess. 2, 7 (1979), *reprinted in* 1980 U.S. Code Cong. & Ad. News 587, 589, 594 (emphasis added). The Senate Report similarly provides: "The windfall profit tax is an excise, or *severance, tax* on domestic oil producers and royalty owners. . . . The windfall profit tax is an excise, or *severance, tax* applying to crude oil produced in the United States according to its classification in one of three tiers." S. Rep. No. 394, 96th Cong., 2d Sess. 2, 29 (1979), *reprinted in* 1980 U.S. Code Cong. & Ad. News 410, 414, 438 (emphasis added). *See infra* pp. 15-16 note 16.

[4]*See infra* p. 17 note 17.

[5]The parties agree that Tenneco is a "producer" within the meaning of the Act and, in the absence of the tax shift clause, would be obligated to pay its ratable share of the Tax.

Marathon Oil Co., 564 F.Supp. 381, 384 (C.D.Cal. 1983), *rev'd*, 756 F.2d 769 (9th Cir. 1985).[6]

The district court specifically rejected Marathon's argument that the Tax is not upon acts or operations on the property, but rather upon an economic interest in the oil, stating:

> The key to operation of the tax is removal, in that calculation of the tax starts with a "removal price," which is the price for which each barrel of oil is sold or deemed sold. . . .
>
> The Act imposes the [Tax] upon the sale and removal of oil from the producing premises, recognizing that sales of crude are normally made at the wellhead. If oil is removed from the producing premises prior to sale, the statute provides for a constructive sale upon such removal. . . .
>
> Marathon's principal argument . . . that the tax is not upon actions or operations on the property but rather upon an economic interest in oil . . . is . . . at clear odds with the plain language of the tax [Shift] clause [of the subject leases] and provisions of the . . . Act. As may be seen, the [Tax] levy is a *severance* tax on *production*, imposed at the wellhead as each barrel is *removed* and *sold*, actually or constructively. As such, the tax matches perfectly the description in the subject leases of taxes intended by the parties to be shifted. The tax clause specifically applies to taxes referable to any "operations . . . upon the demised premises," to "production," to "severance," to "removal" and to "sale." The conclusion is inescapable

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[6]As previously noted, *see infra* note 2, the district court held that the burden of the Tax was not shifted as to the one lease which did not contain the tax shift clause. 564 F.Supp. at 384.

> that the effect of the tax clause is to shift the incidence of [the Tax] entirely to the operator.

Id. (emphasis in original) (footnote omitted).[7]

On appeal from that portion of the district court's ruling in favor of Tenneco, the Ninth Circuit reversed "on two separate and independent grounds," namely deference to a state court decision and characterization of the Tax. *Tenneco West, Inc. v. Marathon Oil Co.*, 756 F.2d 769, 771 (9th Cir. 1985).

The Ninth Circuit held itself bound by the California Court of Appeal's decision in *Crocker National Bank v. McFarland Energy, Inc.*, 140 Cal.App.3d 6, 189 Cal.Rptr. 302 (1983) (hearing denied), even though the issue decided by *Crocker* was a question of federal law.[8] In *Crocker,* a copy of which is appended hereto as Appendix D, the state court confronted a tax shift clause substantially similar to the ones in this case and rejected any characterization of the Tax as a severance tax:

> Had Congress desired to impose a tax on removal, other language would have been used. Then, no reference to profit, windfall or otherwise, would have been required. Such a tax would have been imposed based on the number of barrels produced.

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[7]The district court noted and implicitly rejected the characterization of the Tax and the reasoning employed by the California Court of Appeal's contrary decision in *Crocker National Bank v. McFarland Energy, Inc.*, 140 Cal.App.3d 6, 189 Cal.Rptr. 302 (1985) (hearing denied). 564 F.Supp. at 384 n.2.

[8]The Ninth Circuit held itself bound by *Crocker* "[i]n the absence of any evidence that the California Supreme Court would reach a different result." 756 F.2d at 771-72. In fact, substantial evidence indicates that the California Supreme Court would reach a different result. *See infra* pp. 20-22.

140 Cal.App.3d at 10, 189 Cal.Rptr. at 304. Instead, the state court found the Act to impose an excise tax on profit which "is referable to the revenue generated from *sales*." *Id.* (emphasis added). Then, although the tax shift clause explicitly covered "all taxes . . . upon or referable to . . . the *sale* of any . . . hydrocarbon," *id.* at 7-8, 189 Cal.Rptr. at 302-03 (emphasis added), the state court held that the Tax was *not* shifted. *Id.* at 10, 189 Cal.Rptr. at 304.

Tenneco submits that the Ninth Circuit was not bound by *Crocker* because construction of the Tax is a federal question. Moreover, *Crocker* is in error as to its characterization of the Tax as a "sales tax" and its application of the contract language.

As a second "separate and independent ground" for its decision, the Ninth Circuit made its own assessment of the nature of the Tax, describing the Tax as being imposed "on excess revenue realized as a result of decontrol," and holding that the Tax was "not . . . upon or referable to any operations or acts of Marathon." 756 F.2d at 773. The Ninth Circuit recognized that the Tax was generated by Marathon's severance activities, but concluded: "That liability for the tax is triggered by removal and sale of the oil does not make it 'upon or referable to' those acts." *Id.* This mischaracterization of the Tax and misconstruction of the subject leases must be addressed by this Court.

How the Tax is characterized affects the parties to every agreement allocating oil production taxes. Tenneco alone holds more than one hundred leases containing similar tax shift clauses with numerous other lessees besides Marathon.[9] The impact of the Tax with respect to

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[9]These other lessees include, *inter alia*, Aminoil Inc., Atlantic Richfield Company, Chevron U.S.A., Inc., Crestmont Oil and Gas Company, Getty Oil Company, Gulf Oil Corporation, Occidental

many of these leases is the subject of three pending California Superior Court cases which have been consolidated for trial.[10] When this case is combined with the yet unresolved state court cases, Tenneco's total stake in the controversy presently exceeds $32,000,000. In addition to Tenneco, other entities with similar contractual relationships, both private and governmental, will be impacted by the decision in this case.

ARGUMENT

I

IF CERTIORARI IS NOT GRANTED, THE DECISION OF THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT WILL RESULT IN THE MISINTERPRETATION AND MISAPPLICATION OF THE CRUDE OIL WINDFALL PROFIT TAX, THE WRONGFUL LOSS OF REVENUE TO COUNTLESS CORPORATIONS, INDIVIDUAL ROYALTY OWNERS AND THE UNITED STATES TREASURY, AND A POTENTIAL CONFLICT AMONG THE FEDERAL CIRCUITS

This case will impact dramatically on individual, corporate and governmental interests in oil producing properties, including all federal lands leased for the production

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Petroleum Corporation, Shell Oil Company, Standard Oil Company of California, The Superior Oil Company, Texaco, Inc. and Union Oil Company of California.

[10] *Getty Oil Co. v. Tenneco West, Inc.*, No. 178448 (Cal. Super. Ct. Kern County filed March 12, 1982); *Tenneco West, Inc. v. Standard Oil Co.*, No. C404917 (Cal. Super. Ct. Los Angeles County filed March 24, 1982); *Gulf Oil Corp. v. Tenneco West, Inc.*, No. 188423 (Cal. Super. Ct. Kern County filed Oct. 11, 1984). These cases have been consolidated in Kern County under Judicial Council Coordinated Proceeding No. 1529 and have been stayed by the state court pending the outcome of this petition.

of oil. If not corrected, the Ninth Circuit's decision will result in the unintended and inequitable transfer of possibly hundreds of millions of dollars. This Court has upheld the constitutionality of the Act[11] but has not yet determined the *nature* of the Tax. As this case illustrates, such a determination is critical since it will impact every crude oil royalty sharing arrangement in which production taxes are shared or "shifted" between the parties.

In addition to its own cases, Tenneco is aware of another series of pending cases involving substantially identical issues: *Mobil Oil Corp. v. City of Long Beach*, 578 F.Supp. 1197 (C.D.Cal. 1984) (appeals pending) and *Shell California Production, Inc. v. City of Long Beach*, No. 83-6466-R (C.D.Cal. March 20, 1984) (judgment and statement of uncontested facts and conclusions of law) (appeal pending).[12] It is estimated that the amount in controversy in these two cases exceeds $20,000,000. Involving somewhat different issues, but still to be affected by this case's outcome, is *New Mexico v. Regan*, 745 F.2d 1318 (10th Cir. 1984) (transferred to Ct.Cl.), *cert. denied*, 105 S.Ct. 2138 (1985), in which the State of New Mexico is challenging the Secretary of the Treasury's practice of deducting the Tax from royalties earned from oil production on federal lands before paying 50 percent of those royalties to the states in which the lands are located, as required by the Mineral Lands Leasing Act, 30 U.S.C. §§ 181 *et seq.* *See* 745 F.2d at 1319.

The essential facts of *Mobil*, a copy of which is appended hereto as Appendix E, are that in 1965, five oil

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[11] *United States v. Ptasynski*, 462 U.S. 74, 103 S.Ct. 2239, 76 L.Ed.2d 427 (1983).

[12] The related California Superior Court case for both *Mobil* and *Shell California* is *State of California v. Texaco, Inc.*, No. C471629 (Cal. Super. Ct. Los Angeles County filed Oct. 13, 1983).

companies[13] entered into an oil production agreement with the City of Long Beach. Under the agreement, the oil companies have the right and obligation to produce oil from property owned by Long Beach, purchase at certain prices the oil so produced, deduct production expenses from the purchase price, and divide with Long Beach the remaining net profit. 578 F.Supp. at 1198. Since its enactment, the oil companies have been deducting the Tax as a production expense in computing the net profit to be shared with Long Beach. *Id.* at 1198-99.

The oil companies maintain that their agreement allows excise taxes to be charged against net profit and that the Tax constitutes an excise tax. *Id.* at 1199.[14] Long Beach, on the other hand, joined by the State of California, has asserted that the Tax "is in the nature of a profits tax" and, therefore, not deductible under the agreement. *Id.*

The underlying facts of *Shell California*, a copy of which is appended hereto as Appendix F, are identical to those of *Mobil*.[15] Unlike the district court in *Mobil*, which dismissed for lack of federal question jurisdiction, 578 F.Supp. at 1199, the district court in *Shell California* held that the issue of determining the nature of the Tax did present a substantial federal question, statement ¶1, Appendix F hereto at F3, and, further, that the Tax was "an

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[13]Exxon Corporation, Mobil Oil Corporation, Shell Oil Company, Texaco, Inc. and Union Oil Company of California.

[14]Interestingly, this position is in obvious conflict with the position being asserted by three of the five oil companies (Shell, Texaco and Union) which are Tenneco's lessees in the state court proceedings related to this case. *See supra* pp. 8-9 and note 10.

[15]Shell California Production, Inc. became the assignee of Shell Oil Company's interest under the agreement with the City of Long Beach on June 1, 1981. Statement ¶14, Appendix F hereto at F5.

excise or severance tax and . . . *not in the nature of an income or profits tax*," judgment, Appendix F hereto at F-1 (emphasis added). In particular, the district court concluded:

> 10. The Windfall Profit Tax, 26 U.S.C. §§ 4986-4998, as amended, is *an excise or severance tax*. The Windfall Profit Tax is *not a tax on income or profits*, nor is it in the nature of a tax on income or profits. . . .
>
> 11. The relevant statutory language in 26 U.S.C. § 4986(a) (Supp. V 1981) plainly characterizes the Windfall Profit Tax as an excise tax.
>
> 12. *The legislative history* underlying the Windfall Profit Tax *shows that Congress intended the Windfall Profit Tax to be an excise or severance tax not in the nature of an income or profits tax.*

Statement ¶¶10-12, Appendix F hereto at F4-F5 (emphasis added).

New Mexico v. Regan, a copy of which is appended hereto as Appendix G, involves the provisions of the Mineral Lands Leasing Act ("Mineral Act"), 30 U.S.C. §§ 181 *et seq.* Permitting the states in which federally owned lands are located to share in the royalties paid to the federal government by crude oil producers operating on such lands, the Mineral Act provides in pertinent part:

> All money received from sales, bonuses, royalties . . . and rentals of the public lands under the provisions of this chapter . . . shall be paid into the Treasury of the United States; 50 per centum thereof shall be paid by the Secretary of the Treasury to the state other than Alaska within the boundaries of which the leased lands or deposits are or were located . . . .

30 U.S.C. § 191. Since enactment of the Tax, the United States has calculated the state's shares of crude oil royalties received from federal lands *after* deduction of the Tax. 745 F.2d at 1319. In 1981, New Mexico commenced suit against the Secretary of the Treasury claiming that the Mineral Act requires payment to the states of 50 percent of federal royalties undiluted by the Tax. *Id.*

The Secretary asserts that the United States' position is supported by the intent of Congress in passing the Tax. *Id. If the Tax is deemed to be a severance tax on production, the United States' pre-distribution deduction of the tax is justified* as a production cost reduction of the royalty amount paid by the producer. The Tax is imposed independent of income and consequential royalty obligations. Liability for the Tax attaches before royalties are received by the Treasury and before payment to the states at their 50 percent share. The Tax is directed at production, not the royalty interest which, in the absence of a tax shift clause, determines only the share of the Tax to be borne by the royalty interest holder.

However, *if the tax is viewed as relating not to production but rather to income or profits, then New Mexico's position that the states' royalty payments may not be reduced is buttressed.* Under this mischaracterization, the Tax is inextricably linked to the federal government's royalty interest which must be shared with the states under the Mineral Act without reduction.

In terms of the amount in controversy, the *New Mexico* court observed:

> New Mexico seeks to change in a significant manner the Secretary's methods of calculating the windfall tax and state royalties; *this change would clearly*

> *reduce amounts already collected in the Treasury* pursuant to the windfall profits tax and require the payment of substantial sums to New Mexico.
>
> . . . .
>
> In its complaint New Mexico noted that the Treasury had collected $3,255,000 in federal royalties from federal lands in New Mexico over a five-month period in 1980. *Reducing the taxable royalties derived from public lands located in New Mexico by 50 [percent]* for this five-month period alone *would significantly decrease federal revenues, not to mention the dramatic national impact of such a change when considering its future application to all federal lands.*

Id. at 1320 & n.2 (emphasis added).

As evidenced by *Mobil, Shell California,* and *New Mexico,* the questions presented by this case are of substantial commercial and federal importance. Although this is the first case with such issues to be litigated at the federal appellate level, others are certain to follow because of the widespread use of tax-shift clauses and the enormous sums involved. If the nature of the Tax is not resolved by this Court, the federal circuits will inevitably conflict in their determinations of the issue just as the decisions of state courts now stand in conflict, creating geographical inequities and inconsistencies in the application of federal law. In stark contrast to the California appellate court's decision in *Crocker,* the courts of Texas have held the Tax to be "a 'production,' 'severance' or other 'similar' or 'applicable' tax measured by production" such that the Tax is shifted under contractual provisions substantially similar to those in this case. *Humble Exploration Co. v. Amcap Petroleum Associates — 1977,* 658 S.W.2d 860, 861 (Tex.Civ.App. 1983). This petition should be granted by

this Court to cure such conflicts and establish the equitable, consistent and uniform application of the Tax throughout the United States.

II

THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT ERRONEOUSLY CONSTRUED THE CRUDE OIL WINDFALL PROFIT TAX AS A TAX ON INCOME OR PROFITS, IGNORING THE STATUTORY INTENT, LEGISLATIVE HISTORY, AND THIS COURT'S MANDATE TO INTERPRET A TAX BY ITS OPERATION RATHER THAN ITS DESCRIPTIVE LANGUAGE

In holding that the Tax is a tax not on production but on "excess revenue" or windfall profit, the Ninth Circuit misconstrued the intent of Congress. As the Act's legislative history amply indicates, and notwithstanding the inclusion of the word "profit" in the title, Congress enacted a severance tax on production, *not* a tax on income or profits.[16]

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[16]"This is a severance tax, an excise tax . . . . [I]t is a wellhead tax which will attach if they get oil, whether they make any profits or not." 125 Cong. Rec. H5285 (daily ed. June 28, 1979) (statement of Rep. Latta). "[The Tax] does go to the windfall profits that the oil companies will get from decontrol, but the mechanism of the tax is not an excess profits tax. The mechanism is an excise tax, a severance tax." 125 Cong. Rec. H5289-90 (daily ed. June 28, 1979) (statement of Rep. Ullman). "[The Tax] has nothing to do with profits. It is a severance tax purely and simply." 125 Cong. Rec. H5301 (daily ed. June 28, 1979) (statement of Rep. Badham). "[T]he proposed tax . . . is not a tax on profits at all. It is a tax on production that is due whether the producer is or is not making a profit." 125 Cong. Rec. H5531 (daily ed. July 9, 1979) (statement of Rep. Green). "The proposed tax has nothing to do with profits of domestic oil producers, but simply places an excise tax on each barrel of oil produced domestically from certain categories." S. Rep. No. 394, 96th Cong., 2d Sess. 142 (1979), *reprinted in* 1980 U.S. Code Cong. & Ad. News 410, 546 (statement of Sen. Gravel). "When the Senate Finance Committee began its hearings on . . . the crude oil tax, I pointed out

Further, the Ninth Circuit appears to have ignored, despite quoting, this Court's admonition that "the nature of a tax must be determined by its operation rather than by particular descriptive language which may have been applied to it," *Educational Films Corp. v. Ward*, 282 U.S. 379, 387, 51 S.Ct. 170, 171, 75 L.Ed. 400 (1931). *See* 756 F.2d at 773. The Tax's operation clearly demonstrates the Tax to be a severance tax on production.

With the exception of oil produced from certain "stripper" wells, the Tax is imposed per barrel regardless of the total amount of production per well, leasehold or producer. 26 U.S.C. §§ 4987, 4988(a). In broad terms, each barrel is taxable at the same rate, from the first to the last barrel produced each year. 26 U.S.C. § 4987. The only deduction or adjustment to the Tax uniformly available to all producers under the Act is an adjustment for state severance taxes. 26 U.S.C. §§ 4988(a), 4996(c). That deduction is allowed because the two taxes are duplicative. No one has made this point more clearly than Marathon's own staff attorney, Hak K. Dickenson:

> Thus, although the severance tax adjustment is a deduction in computing the [Tax], it is a form of tax

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to the Secretary of the Treasury . . . that the tax is not a 'windfall profits tax.' The proposal which is reported out by the Committee is not a tax on profits. Nowhere is the term, not even the concept, of profits mentioned. Rather, the tax is an extremely complicated excise tax imposed at the wellhead on crude oil." S. Rep. No. 394, 96th Cong. 2d Sess. 165-66 (1979), *reprinted in* U.S. Code Cong. & Ad. News 410, 568 (statement of Sen. Dole). "It is a misnomer to call it an excess profits tax, because it does not have anything to do with whether there are profits. . . . It has only to do with a taxation on the production of oil." 125 Cong. Rec. S18,114 (daily ed. Dec. 10, 1979) (statement of Sen. McClure). "[A]s will be said many times during this debate, the windfall profits tax bears no relationship to profits. As an excise tax imposed at the wellhead, the tax will be applied uniformly on a domestic oil company, whether its property is making large profits, or no profits at all." 125 Cong. Rec. S16,854 (daily ed. Nov. 16, 1979) (statement of Sen. Wallop). "[The Tax is] an excise tax . . . not a profits tax." 125 Cong. Rec. S16,973 (daily ed. Nov. 19, 1979) (statement of Sen. Moynihan).

> credit in the sense that to the extent of the state severance tax paid, no federal severance tax is imposed.

Dickenson, *Severance Tax Adjustment Under the Windfall Profit Tax,* 29 Oil & Gas Tax Q. 257, 257 (1980). Indeed, most commentators view the Tax as a severance tax on production.[17]

That the Tax is not a tax on income or profits is evident from the fact that characteristics inherent in such taxes are foreign to the Tax. As this Court observed in *Burnet v.*

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[17] "[A]lthough called a tax on profits, the tax is a temporary excise or severance tax on production, imposed at the wellhead as each barrel of oil is removed from the ground and sold." 67 Stand. Fed. Tax Rep. (CCH), *Crude Oil Windfall Profit Tax Act of 1980,* ¶ 101 (extra ed., no. 16, 1980). "The windfall profit tax is a temporary excise, or severance, tax applying to taxable crude oil produced in the United States . . . . The windfall profit tax is an excise, or severance, tax on domestic oil producers or royalty owners." Main, Hurdman & Cranstoun, *Analysis of the Crude Oil Windfall Profit Tax: With an Emphasis on the Independent Producer,* 28 Oil & Gas Tax Q. 418, 419, 420 (1980). "Instead of being a tax on income realized over a period of time, the [Tax] is a tax on the discrete act of the removal of crude oil from domestic premises whether or not income is realized." Attermeier & Reveley, *Characterizing the Windfall Profit Tax for State Income Tax Purposes,* 32 Oil & Gas Tax Q. 465, 483-84 (1984). "The windfall profit tax is an excise tax (as opposed to a tax on net profits) that is levied on the producer of the crude oil as the oil is extracted from the ground and sold." Milner, *Resolving Producer/Interest Questions Under the Crude Oil Windfall Profit Tax,* 37 Tax Law. 607, 607 (1984). "The [Tax] is not, as the name suggests, a tax on profits. It is an excise tax (a deductible business expense) on production that is designed to tax part of the revenue resulting from the decontrol of crude oil prices." Lilly & Seymour, *The 1980 Crude Oil Windfall Profit Tax: An Overview from an Industry Perspective,* 24 How. L.J. 125, 131 (1981). "The windfall profit tax is an excise tax and not a tax on 'profits' or taxable income." Mangum, *Evolution of the Crude Oil Windfall Profit Tax — An Examination of Recent Changes,* 13 St. Mary's L.J. 767, 767-68 (1982).

Sanford & Brooks Co., 282 U.S. 359, 362-65, 51 S.Ct. 150, 151-52, 75 L.Ed. 383 (1931), income is determined on the basis of fixed accounting periods, not on the basis of particular transactions. In contrast, as previously discussed, the Tax is determined on a transactional basis by the per-barrel removal of oil from the premises. 26 U.S.C. §§ 4987, 4988(a).

Also inherent in income or profits taxes is the realization of gain. *Inland Steel Co. v. United States*, 677 F.2d 72, 86-87 (Ct.Cl. 1982). A gain is not taxable until it is realized. *Rutkin v. United States*, 343 U.S. 130, 137, 72 S.Ct. 571, 575, 96 L.Ed. 833 (1952). Totally independent of any realization of gain, the Tax is imposed on the *presumed* incremental value of the oil removed that exceeds an *assumed* value for oil in 1979. 26 U.S.C. §§ 4988, 4989. This presumed value is not based on the producer's actual gross receipts. *Id.* § 4988(c)(2)-(4). The Tax is calculated and imposed upon removal of the oil from the premises regardless of any sale or even casualty loss.

Finally, the Tax makes no allowance for recovery of capital or the cost of goods sold. The adjusted base price mechanism bears no relationship to actual capital costs. *Id.* § 4989. In fact, the Act specifically denies recovery of capital in the sale of producing properties. *Id.* § 4988(b)(4).

Obviously, therefore, "windfall profit" is no more than a statutory label adopted for political considerations. *The term has no bearing on the operation of the tax.* It is true, as the Ninth Circuit emphasizes, 756 F.2d at 773, that both the Senate and House Reports express respective committee beliefs that "there should be a tax on the windfall arising from decontrol of crude oil prices." H.R. Rep. No. 304, 96th Cong., 2d Sess. 4 (1979), *reprinted in* 1980 U.S. Code Cong. & Ad. News 597, 591. *See* S. Rep. No. 394, 96th Cong., 2d Sess. 6 (1979), *reprinted in* 1980 U.S.

Code Cong. & Ad. News 410, 417. But these statements, read in conjunction with the entire legislative history and the provisions of the Act, constitute only so much political puffing. The Tax is geared to *production,* not profits. The Ninth Circuit's characterization of the Tax is erroneous and, if left intact, will lead to continued uncertainty, inconsistency and injustice.

III

THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT ERRONEOUSLY DETERMINED THAT IT WAS BOUND BY A STATE APPELLATE COURT'S INTERPRETATION AND APPLICATION OF THE CRUDE OIL WINDFALL PROFIT TAX

Although this case ultimately confronts the state law issue of contractual interpretation, the resolution of that issue depends upon the proper prior characterization of the Tax, a federal question. While recognizing the presence of the underlying federal question, 756 F.2d at 771, the Ninth Circuit nevertheless held itself bound by the state appellate court decision in *Crocker.*

Even in a diversity case, a federal court is under no obligation to adhere to state court pronouncements of state law based upon a misinterpretation of federal law. *E.g., Breisch v. Central R.R. of New Jersey,* 312 U.S. 484, 491, 61 S.Ct. 662, 665, 85 L.Ed. 964 (1941); *Tipton v. Atchison, T. & St. F. Ry. Co.,* 298 U.S. 141, 151-52, 56 S.Ct. 715, 719, 80 L.Ed. 1091 (1936); *Lakeside Bridge & Steel Co. v. Mountain State Construction Co,* 597 F.2d 596, 598-99 (7th Cir.), *cert. denied,* 445 U.S. 907, 100 S.Ct. 1087, 63 L.Ed. 2d 235 (1979). In such a case, the diversity court remains free to reexamine the federal law foundation of the state court decision. *Tipton,* 298 U.S. at 151-52, 56 S.Ct. at 719. Accordingly, *Crocker's* misconstruction of

the Tax as essentially a tax on "sales" and its inexplicable misapplication of the tax shift clause (finding that the Tax was not shifted despite the clause's express language covering a tax on sales) are *not* binding in this case.

Even assuming, *arguendo,* that *Crocker* was a "pure" state law decision, it would still not be binding in this case. A federal court is to resolve issues of state law as it believes the highest court of the state would resolve those same issues. *E.g., Commissioner v. Estate of Bosch,* 387 U.S. 456, 465, 87 S.Ct. 1776, 1782-83, 18 L.Ed.2d 886 (1967); *McKenna v. Ortho Pharmaceutical Corp.,* 622 F.2d 657, 662 (3d Cir.), *cert. denied,* 449 U.S. 976, 101 S.Ct. 387, 66 L.Ed.2d 237 (1980); *Scandinavian Airlines System v. United Aircraft Corp.,* 601 F.2d 425, 427 (9th Cir. 1979). In arriving at this resolution, the federal court is to consider all relevant indicia of state law, including statutes, supreme and lower court decisions, and even treatises. *McKenna,* 622 F.2d at 662-63. Federal courts may not follow state appellate court decisions when analysis of all relevant indicia of state law indicates that the state supreme court would decide differently. When, as in this case, a federal court of appeals is in the position of interpreting state law with no definitive guidance from the state's highest court, "substantial deference" is to be accorded to the district court's interpretation of the law of the state in which it sits, and such interpretation will be accepted on review unless it is "clearly wrong" or "clearly erroneous." *Gaines v. Haughton,* 645 F.2d 761, 770 (9th Cir. 1981).

The California Supreme Court would not follow *Crocker* which unquestionably contravenes established state law. The relevant language of the tax shift clause in *Crocker,* much like the clause in this case, provided that the "Grantor shall pay and discharge before delinquency all taxes . . . upon or referable to any operations or acts of

Grantor . . . including . . . the *sale* of any such hydrocarbon or of any product." 140 Cal.App.3d at 7-8, 189 Cal.Rptr. at 302-03 (emphasis added). The court in *Crocker* found the "Windfall Profit Tax, as we read it, [to be] referable to the revenue generated from *sales*," yet, inexplicably, held the tax *not* to be included within the tax shift clause which on its face encompasses "the *sale* of any . . . hydrocarbon or of any product thereof." *Id.* at 8, 10, 189 Cal.Rptr. at 302-03, 304 (emphasis added).

By either mistakenly overlooking or improperly ignoring explicit language shifting the burden of taxes "referable to sales," the state court violated fundamental and longstanding principles of California contract law. The California Civil Code provides that "[t]he language of the contract is to govern its interpretation." Cal.Civ.Code § 1638. Thus, "where the [contract] language is clear and not absurd it will be followed." *In re Estate of Wemyss,* 49 Cal.App.3d 53, 60, 122 Cal.Rptr. 134, 137 (1975). *See generally* 1 B. Witkin, Summary of California Law, *Contracts* § 521 (8th ed. 1973).

Crocker makes no mention of *Beamer v. Franchise Tax Board,* 19 Cal.3d 467, 563 P.2d 238, 138 Cal.Rptr. 199 (1977). In *Beamer,* the California Supreme Court confronted a Texas tax similar to the Tax in that it was calculated according to "a specified percentage of the 'market value' of the oil and gas 'as and when produced.' " *Id.* at 470, 138 Cal.Rptr. at 199. Despite finding the Texas tax to be measured by "the total gross receipts from the sales of the minerals produced," *id.* at 479, 138 Cal.Rptr. at 206, and acknowledging that the Texas Supreme Court had held the tax to be an income tax for purposes of the Buck Act,[18] *id.,* 138 Cal.Rptr. at 205, the California

[18] 4 U.S.C. §§ 105 *et seq.* (permits states to impose specified taxes, including "income taxes," in federal enclaves).

Supreme Court nevertheless held that the tax could not be characterized as a tax "on income" or " 'on or according to or measured by income or profits,' " *id.* at 470, 480, 138 Cal.Rptr. at 199, 206. The California Supreme Court observed that production costs were not deductible in computing the tax, *id.* at 477, 138 Cal.Rptr. at 204, and that the tax was imposed without true realization of income, *id.* at 478-79, 138 Cal.Rptr. at 205.

Nor does *Crocker* mention that the California Franchise Tax Board previously determined the Tax to be deductible for state corporate income tax purposes. California Franchise Tax Board, *Resolution Regarding Deductibility of Taxes Imposed by the Federal Crude Oil Windfall Profit Tax Act of 1980* (Oct. 1, 1981). *See* 1 St. Tax Rep. [Cal.] (CCH), *FTB Letter to CCH,* ¶ 10-561.32 (Oct. 5, 1981). Under California law, a tax "on or according to or measured by income or profits" is *not* deductible. Cal. Rev. & Tax. Code § 24345(a)(2). Accordingly, the California Franchise Tax Board's resolution amounts to a determination under California law that the Tax is *not* an income or profits tax.

To summarize, the federal courts are not subservient to the state courts on issues of federal law, but are obligated to ignore any state court decision misconstruing or misinterpreting federal law. Federal appellate courts are to follow a federal district court's state law ruling unless it is clearly erroneous. *Crocker* utterly disregards binding administrative and California Supreme Court rulings and should not have been accorded any weight whatsoever by the Ninth Circuit in interpreting the Tax. By following *Crocker,* the Ninth Circuit is essentially in conflict with California law. Unless this petition is granted, it is only a matter of time before the Ninth Circuit's decision in this case also conflicts with other federal appellate courts.

CONCLUSION

Tenneco respectfully requests this Court to issue a writ of certiorari to the Ninth Circuit in order to settle the important issues of federal law in this case. The Ninth Circuit's flawed decision will cause great inequities and inconsistencies if not rectified. Not only innumerable corporations and individuals, but also the United States Treasury will be wrongfully deprived of vast sums of money if the Ninth Circuit's decision is allowed to stand. Inevitably, other court decisions will continue to conflict with the Ninth Circuit's erroneous interpretation of the Tax, and the realization of justice will ultimately depend upon the fortunes of geography rather than the uniform application of federal law.

The Ninth Circuit erroneously interpreted the Tax to be a tax on income or profits. The legislative history and the Tax's operation, buttressed by the decisions of other courts, prove instead that the Tax is not an income or profits tax, but rather an excise or severance tax on oil production. A definitive characterization of the Tax by

this Court is necessary. Tenneco respectfully submits that this petition should be granted.

DATED: June 27, 1985

Respectfully submitted,

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APPENDIX A

Tenneco West, Inc. v. Marathon Oil Co., 564 F.Supp. 381 (C.D. Cal. 1983), *rev'd*, 756 F.2d 769 (9th Cir. 1985)

TENNECO WEST, INC.,
A DELAWARE CORPORATION,
PLAINTIFF
v.
MARATHON OIL COMPANY,
AN OHIO CORPORATION,
DEFENDANT
No. CV 82-1492 RG(Px)
United States District Court,
C.D. California.
June 10, 1983.

ORDER
(SUMMARY JUDGMENT)
GADBOIS, District Judge.

STATEMENT OF FACTS

Plaintiff Tenneco West, Inc. ("Tenneco") commenced this action in 1982 by a complaint for declaratory relief against Marathon Oil Company ("Marathon"). The parties' cross-motions for summary judgment prompt this decision. The essential facts are undisputed. Accordingly, the case is an appropriate one for disposition by summary judgment.

Between 1933 and 1938, Tenneco, as lessor, and Marathon, as lessee, entered into oil and gas leases involving four tracts in Kern County, California. These leases were designated I-MA-27, II-MA-30, II-MA-48, II-MA-106. Under the latter three leases the lessor is entitled to percentage royalties on the crude oil produced from the

leased premises in the amounts of 22.5%, 23% and 23.5%, respectively, or a royalty of 50% of the net profit, whichever is greater. Lease I-MA-27 entitles the lessor only to a percentage royalty of 22.5% and contains no alternative net profit provision. Leases I-MA-27, II-MA-30 and II-MA-106 provide that the lessor's royalty is payable either in kind (*i.e.*, in crude oil), or in money. The royalty on lease II-MA-48 is payable in money only.

Each of the four subject leases contains language substantially identical to the following net royalty clause:

> All royalty payments made to the Lessor hereunder shall be computed and made without any deduction or charge on account of any cost or expense of exploration, development, production, extraction, treatment, compression, recycling, transportation, lifting, collecting, gathering, sale, delivering, cleaning, or dehydration, or any other deduction or charge whatsoever whether of same or different character and whether or not incidental or relating to the unit operation. . . .

Leases II-MA-30, II-MA-48, and II-MA-106 contain language substantially identical to the following "tax shift" clause:

> TAXES, ASSESSMENT, ETC. ON ACCOUNT OF OPERATIONS, ETC. The Lessee shall, at its own expense, and without reimbursement by the Lessor, pay and discharge any and all taxes, charges or assessments upon or referable to any operations or acts of the Lessee or on its behalf upon the demised premises, including (but not by such inclusion limiting the generality of the foregoing) the drilling or operation of any well or wells, the production, extraction, severance or removal of any oil or other products, the processing, refining, storage or use thereof,

> the sale of any such oil or other products or of any products manufactured therefrom or therewith, or the transportation thereof away from the demised premises; and the Lessee shall also at its own expense, and without reimbursement by the Lessor, pay and discharge any and all assessments, charges or obligations of any kind whatsoever which, by reason of any operations of the Lessee, may be or might become a lien upon or charge against the demised premises, or any part thereof, or any well situate thereon (including, but by such inclusion in nowise limiting the scope of the foregoing provisions, any charge, assessment, claim or obligation created by or arising under Chapter 718 of the Statutes of 1915 of the State of California, or any act amendatory thereof or supplemental or additional thereto) whether the same shall be created or shall arise under or by reason of any present or future law, ordinance, regulation or order whatsoever.

At the time the leases were executed, and until March 1980, there were no Federal or California taxes on the production, extraction, severance, or removal of hydrocarbons. However, in March of 1980 the provisions of the Federal Crude Oil and Windfall Profit Tax Act, 26 U.S.C. §§ 4986-98, became effective. Since the operative date of the Act, Marathon has withheld from its royalty payments due Tenneco an amount equal to the WPT attributable to Tenneco's royalty interest in the subject leases. Marathon has transmitted these amounts to the Treasury for Tenneco's account.

The parties agree that Tenneco is a "producer" within the meaning of the Act and, hence, in the absence of a valid agreement in the subject leases shifting incidence of the tax, it would be obligated to pay its ratable share of

WPT attributable to the production from the leased acreage.

ISSUE

The issue in this case is whether, as between the parties only, defendant must bear the entire WPT resulting from production from the leased properties or whether it must be apportioned between the parties as provided in the WPT Act. In urging the former proposition, plaintiff contends that the parties have, by agreement, effectively shifted incidence of the tax to defendant. Plaintiff relies for this purpose on the net royalty clause of each lease and on the "tax on operations" clause of the three leases which contain it.

ALLOCATION OF TAXES

It is axiomatic that parties to a contract may agree as to which of them will bear the burden of taxes imposed by reason of actions contemplated by the contract. *Safe Harbor Water Power Corp. v. United States*, 303 F.2d 928, 157 Ct.Cl. 912 (Ct.Cl. 1962). This principle is fully applicable to oil and gas leases. 47 Cal.Jur.3d § 47.

It is likewise clear that a contractual tax allocation clause will be effective as to taxes enacted after formation of the agreement if the language of that provision can be construed as applying to the particular tax in issue. *J.W. Perry Company v. City of Norfolk*, 220 U.S. 472, 31 S.Ct. 465, 55 L.Ed. 548 (1911); *Terminal Inv. Co. v. Pope Estate Co.*, 122 Cal.App. 281, 10 P.2d 139 (1932).

A careful review of the WPT Act itself and the available legislative history behind the statute fails to disclose evidence of Congressional intent that the above rules

should not govern incidence of the WPT in appropriate cases.

ROYALTY CLAUSE

Tenneco contends that the net royalty clause of each lease compels Marathon to bear the entire WPT. That position is untenable. Certainly this clause creates a royalty interest which is free of production expenses and deductions, but it cannot be construed as embracing an excise tax imposed by its terms directly on the royalty owner. Although the working interest operator withholds and transmits the WPT attributable to the royalty interest this is not a "deduction" or "expense" in any sense intended by the parties executing the lease. The net royalty language simply cannot reasonably be interpreted to shift incidence of the WPT to the defendant. It is significant that each lease has extensive and specific treatment of some taxes, but the word "tax" is not used at all in the royalty provisions.

TAX CLAUSE

The heart of this case is the question of whether the above-quoted tax on operations provision contained in three of the subject leases operates to shift all WPT to Marathon. Resolution of this question requires close analysis of the Act in order to determine its precise nature.

The Conference Committee Report, which attended enactment of the WPT, described the tax as "a temporary excise or severance tax." 838 CCH Stan.Fed.Tax Rep. ¶ 4972.-15. The Act itself describes the tax:

> An excise tax is hereby imposed on the windfall profit from taxable crude oil removed from the premises during each taxable period.

26 U.S.C. § 4986(a).

The key to operation of the tax is removal, in that calculation of the tax starts with a "removal price," which is the price for which each barrel of oil is sold or deemed sold. The tax structure created by the Act is very complex, but essentially the tax is equal to each barrel's removal price, less its adjusted base price and any state severance tax adjustment, multiplied by the applicable oil tier rate.

The Act imposes the WPT upon the sale and removal of oil from the producing premises, recognizing that sales of crude are normally made at the wellhead. If oil is removed from the producing premises prior to sale, the statute provides for a constructive sale upon such removal. The same treatment is accorded to refining upon the premises as of the day that process commences. 26 U.S.C. § 4988(c)(3)-(4). The exceptions to this constructive sale and removal rule are few and narrowly drawn, and they generally involve use of the oil in tertiary recovery or in a fraccing process on the premises. Reg. § 51.4996-1(d).

Marathon's principal argument on this issue is that the tax is not upon actions or operations on the property but rather upon an economic interest in oil. This position, which is imaginative and most ably presented, is nonetheless at clear odds with the plain language of the tax on operations clause and provisions of the WPT Act. As may be seen, the WPT levy is a *severance* tax[1] on *production*, imposed at the wellhead as each barrel is *removed* and

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[1]The Act's credit for state severance taxes buttresses this characterization.

sold, actually or constructively. As such, the tax matches perfectly the description in the subject leases of taxes intended by the parties to be shifted. The tax clause specifically applies to taxes referable to any "operations . . . upon the demised premises," to "production," to "severance," to "removal" and to "sale." The conclusion is inescapable that the effect of the tax clause is to shift the incidence of WPT entirely to the operator.

DECISION

Lease I-MA-27 contains the net royalty clause but not the tax on operations language. The only tax provisions of that lease refer to property taxes and are clearly inapplicable to the WPT. Accordingly, the court will declare that, with respect to production from that lease, Tenneco must bear its ratable portion or WPT. With respect to the other subject leases the tax clause effectively shifts the entire WPT to Marathon.[2]

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[2]The court is aware of the contrary decision by the California Court of Appeal in *Crocker National Bank v. McFarland Energy, Inc.*, 140 Cal.App.3d 6, 189 Cal.Rptr. 302 (1983).

APPENDIX B

Tenneco West, Inc. v. Marathon Oil Co., 756 F.2d 769 (9th Cir. 1985)

TENNECO WEST, INC.,
PLAINTIFF-APPELLEE,

v.

MARATHON OIL COMPANY,
DEFENDANT-APPELLANT.

No. 84-6333.

United States Court of Appeals,
Ninth Circuit.

Argued and Submitted March 4, 1985.

Decided March 29, 1985.

Before PREGERSON and REINHARDT, Circuit Judges, and SCHWARZER,* District Judge.

Schwarzer, District Judge:

The question presented on this appeal is whether the district court was correct in ruling that the tax clause in certain oil and gas leases shifts from lessor to lessee the incidence of the tax levied under the Crude Oil Windfall Profit Tax Act of 1980 ("Act"), 26 U.S.C. §§ 4986 *et seq.* (1982).

Tenneco West, Inc., plaintiff and appellee, ("Tenneco") is the lessor under certain oil and gas leases in Kern County, California. Marathon Oil Company, defendant and appellant, ("Marathon") is the lessee. The tax shifting clause in their leases requires Marathon to pay "any

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* The Honorable William W. Schwarzer, United States District Judge for the Northern District of California, sitting by designation.

and all taxes ... upon or referable to any operations or acts of [Marathon] ... including ... the drilling or operation of any well or wells, the production, extraction, severance or removal of any oil ..., the processes, refining, storage or use thereof, [and] the sale ... or the transportation thereof away from the demised premises."

Taking the position that this provision does not shift windfall profit taxes, Marathon has been withholding from the royalty payments due Tenneco under the leases the amounts of the tax attributable to Tenneco's royalty interest and remitting those amounts to the government. Tenneco made a demand on Marathon that it remit the full amount of the royalty to Tenneco and pay the applicable tax out of its own funds in accordance with the tax shifting clause. Marathon having refused, Tenneco brought this action for declaratory relief.

On cross-motions for summary judgment, the district court held the windfall profit tax to be a severance tax on production, imposed on each barrel of oil on removal and sale. As such it was found to fall within the scope of the tax clause which shifts to the lessee Marathon all taxes referable to operations upon the demised premises including taxes on production, severance, removal and sale.[1]

Because the question decided below was one of law, we review the decision de novo. We conclude that the decision of the district court was erroneous and reverse. Our decision rests on two separate and independent grounds.

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[1]The opinion of the district court is reported at 564 F.Supp. 381 (C.D.Cal.1983).

I

Tenneco brought this action to secure a declaration of its right under the leases to receive royalty payments free of the tax. Jurisdiction was founded on diversity of citizenship. State law therefore defines the rights of the parties. *Erie Railroad Co. v. Tompkins,* 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188 (1938); *Albert v. Joralemon,* 271 F.2d 236, 239 (9th Cir.1959) (lease interpretation a state law question); 28 U.S.C .§ 1652. State law includes the decisions of state courts. Where an intermediate appellate state court has decided an issue of state law, that decision "is not to be disregarded by a federal court unless it is convinced . . . that the highest court of the state would decide otherwise" particularly "where . . . the highest court has refused to review the lower court's decision. . . ." *West v. A.T. & T. Co.,* 311 U.S. 223, 237, 61 S.Ct. 179, 193, 85 L.Ed. 139 (1940); *See also Stoner v. New York Life Insurance Co.,* 311 U.S. 464, 467, 61 S.Ct. 336, 337, 85 L.Ed. 284 (1940); *Werner v. Hearst Publishing Co.,* 297 F.2d 145, 148 (9th Cir.1961).

In *Crocker National Bank v. McFarland Energy, Inc.,* 140 Cal.App.3d 6, 189 Cal.Rptr. 302 (2d Dist.1983) (hearing denied), the California Court of Appeal interpreted a tax clause in an oil and gas lease containing language substantially identical to that before us. In that case, a royalty interest was conveyed subject to the obligation of the grantor to pay all taxes "upon or referable to any operations or acts [on the property subject to the lease] including . . . the . . . production, extraction, severance . . . removal . . . [or] sale" of oil. 140 Cal.App.3d at 7-8, 189 Cal.Rptr. 302. The case differed from that before us only in that the grantor of the royalty interest, rather than the grantee, was the operator of the property,

a difference immaterial to the interpretation of the conveyance.

The court interpreted "taxes referable to any operations or acts" on the property as not including the windfall profit tax. It rejected the argument that the tax was on the removal of oil, reasoning that if that had been intended the references to profit in the Act would be surplusage and the tax would have been imposed on the basis of the number of barrels removed.

While interpretation of the Act presents a federal question, determining whether the tax clause in the leases shifts the tax, however it may be characterized, is a matter of state law.[2] We interpret the *Crocker* decision as holding that the language of the tax clause does not shift

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[2]The question before us is entirely different from that in *Commissioner v. Estate of Bosch*, 387 U.S. 456, 87 S.Ct. 1776, 18 L.Ed.2d 886 (1967), on which Tenneco relies. The question there concerned the effect of a state trial court determination of property interests on adjudication of federal estate tax liability in the federal court.

Nor does *Tipton v. Atchison, T. & St. F. Ry Co.*, 298 U.S. 141, 56 S.Ct. 715, 80 L.Ed. 1091 (1936), lend support to Tenneco's argument. The Court there said:

> If these decisions of intermediate courts of appeal, and the refusal of the Supreme Court of California to review them, amount to no more than a judicial construction of the compensation act as having, by its terms, no application in the circumstances, they are binding authority in federal courts. If, on the other hand, the state courts excluded railroad employees injured in intrastate operations from the benefits of the compensation act, not as a matter of construction of the statute, but because they thought the Safety Appliance Acts required the State to afford a remedy in the nature of an action for damages, then the court below was right in disregarding that erroneous construction of the federal acts.

this tax. In the absence of any evidence that the California Supreme Court would reach a different result, that decision is binding on us.

II

Even if we were to accept Tenneco's argument that the characterization of the tax presents a threshold federal question, we would reach the same result.

The Act imposes an "excise tax ... on the windfall profit from taxable crude oil removed from the premise. ..." 26 U.S.C. § 4986(a). The tax is imposed on the producer of oil, defined as the "holder of the economic interest with respect to the crude oil." 26 U.S.C. § 4996(a)(1)(A). This includes royalty owners such as Tenneco. *See* S.Rep. No. 394, 96th Cong., 2d Sess. 1, *reprinted in* 1980 U.S.Code Cong. & Ad. News 410, 413. Windfall profit is defined as "the excess of the removal price of the barrel of crude oil over the ... base price of such barrel." 26 U.S.C. § 4988(a).

The purpose and operation of the tax was described by the Supreme Court in *United States v. Ptasynski*, 462 U.S. 74, 76, 103 S.Ct. 2239, 2241, 76 L.Ed.2d 427 (1983) as follows:

> In 1979, President Carter announced a program to remove price controls from domestic oil by September 30, 1981. ... By eliminating price controls, the President sought to encourage exploration for new oil and to increase production of old oil from marginally economic operations. ... He recognized, however, that deregulating oil prices would produce

298 U.S. at 151-2, 56 S.Ct. at 719 (footnotes omitted). The *Crocker* decision is a judicial construction of the terms of a lease, not of federal law.

> substantial gains (referred to as "windfalls") for some producers. The price of oil on the world market had risen markedly, and it was anticipated that deregulating the price of oil already in production would allow domestic producers to receive prices far in excess of their initial estimates. . . . Accordingly, the President proposed that Congress place an excise tax on the additional revenue resulting from decontrol.
>
> Congress responded by enacting the Crude Oil Windfall Profit Tax Act of 1980, . . . The Act divides domestic crude oil into three tiers and establishes an adjusted base price and a tax rate for each tier. . . . The base prices generally reflect the selling price of particular categories of oil under price controls, and the tax rates vary according to the vintages and types of oil included within each tier.

Id. (citations omitted).

Tenneco argues that the tax is a severance tax on production imposed at the wellhead as oil is removed and sold, and thus falls squarely within the explicit provisions of the tax clause. In support of this interpretation, Tenneco points to various statements by Congressmen describing the windfall profit tax as a severance tax and to the following statement contained in a House Report:

> The windfall profit tax is an excise, *or severance,* tax applying to all crude oil produced in the United States. . . .

H.R.Rep. No. 96-304, *supra,* at 2, U.S.Code Cong. & Admin.News at 589 (emphasis added).

When read in context of the legislative history, however, these statements do not support Tenneco's position.

Both the Senate and the House reports make it clear that the tax is on excess revenue realized as a result of decontrol. Thus the Senate Report states:

> The [Senate Finance] committee believes that the large price increases on previously discovered oil resulting from phased decontrol are an appropriate object of taxation.

S.Rep. No. 394, 96th Cong., 2nd Sess. 6, *reprinted in* 1980 U.S.Code Cong. & Ad. News, 410, 417. The House Report contains similar language.

> The committee believes that there should be a tax on the windfall arising from decontrol of crude oil prices and from excessive increases in world oil prices.

H.R.Rep. No. 304, 96th Cong., 2nd Sess. 4, *reprinted in* 1980 U.S.Code Cong. & Ad. News 587, 591.

Moreover, "the nature of a tax must be determined by its operation rather than by particular descriptive language which may have been applied to it." *Educational Films Corp. v. Ward,* 282 U.S. 379, 387, 51 S.Ct. 170, 171, 75 L.Ed. 400 (1931). Here the tax is imposed upon incremental revenue. That liability for the tax is triggered by removal and sale of the oil does not make it "upon or referable to" those acts. It is the vintage and type of the oil, and other factors specified in the Act, that determine whether windfall profit tax is due upon its removal or sale. If the price realized on removal does not exceed the statutory base price or other statutory limitations,[3] no tax is due.

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[3]For example, § 4988(b)(1) limits windfall profit to 90 percent of the net income attributable to the barrel involved. Sections

Tenneco's argument, that its receipt of taxable revenue from the sale of oil is "referable to" Marathon's acts on the property, when carried to its logical conclusion, would lead to shifting its income tax liability attributable to that oil to Marathon as well, a result clearly not contemplated by the tax clause.

We conclude, therefore, that the windfall profit tax is not a tax upon or referable to any operations or acts of Marathon.

The judgment is reversed and the case remanded for entry of judgment for appellant.

4988(a)(2) and 4996(c) permit an adjustment for additional state severance taxes paid as a result of oil decontrol.

APPENDIX C

Crude Oil Windfall Profit Tax Act, 26 U.S.C. §§ 4986, 4987, 4988, 4989, 4996

§ 4986. Imposition of tax

(a) Imposition of tax. — An excise tax is hereby imposed on the windfall profit from taxable crude oil removed from the premises during each taxable period.

(b) Tax paid by producer. — The tax imposed by this section shall be paid by the producer of the crude oil.

§ 4987. Amount of tax

(a) In general. — The amount of tax imposed by section 4986 with respect to any barrel of taxable crude oil shall be the applicable percentage of the windfall profit on such barrel.

(b) Applicable percentage. — For purposes of subsection (a) —

(1) General rule for tiers 1 and 2. — The applicable percentage for tier 1 oil and tier 2 oil which is not independent producer oil is —

Tier 1 70

Tier 2 60

(2) Independent producer oil. — The applicable percentage for independent producer oil which is tier 1 oil or tier 2 oil is —

Tier 1 50

Tier 2 30

(3) Tier 3 oil. —

(A) In general. — The applicable percentage for tier 3 oil which is not newly discovered oil is 30 percent.

(B) Newly discovered oil. — The applicable percentage for newly discovered oil shall be deter mined in accordance with the following table:

for taxable periods beginning in:	The applicable percentage is:
1984, 1985, 1986, or 1987	22½
1988	20
1989 and thereafter	15

(c) Fractional part of barrel. — In the case of a fraction of a barrel, the tax imposed by section 4986 shall be the same fraction of the amount of such tax imposed on the whole barrel.

§ 4988. Windfall profit; removal price

(a) General rule. — For purposes of this chapter, the term "windfall profit" means the excess of the removal price of the barrel of crude oil over the sum of —

(1) the adjusted base price of such barrel, and

(2) the amount of the severance tax adjustment with respect to such barrel provided by section 4996(c).

(b) Net income limitation on windfall profit. —

(1) In general. — The windfall profit on any barrel of crude shall not exceed 90 percent of the net income attributable to such barrel.

(2) Determination of net income. — For purposes of paragraph (1), the net income attributable to a barrel shall be determined by dividing —

(A) the taxable income from the property for the taxable year attributable to taxable crude oil, by

(B) the number of barrels of taxable crude oil from such property taken into account for such taxable year.

(3) Taxable income from the property. — For purposes of this subsection —

(A) In general. — Except as otherwise provided in this paragraph, the taxable income from the property shall be determined under section 613(a).

(B) Certain deductions not allowed. — No deduction shall be allowed for —

(i) depletion,

(ii) the tax imposed by section 4986,

(iii) section 263(c) costs, or

(iv) qualified tertiary injectant expenses to which an election under subparagraph (E) applies.

(C) Taxable income reduced by cost depletion. — Taxable income shall be reduced by the cost depletion which would have been allowable for the taxable year with respect to the property if —

(i) all —

(I) section 263(c) costs, and

(II) qualified tertiary injectant expenses to which an election under subparagraph (E) applies, incurred by the taxpayer had been capitalized and taken into account in computing cost depletion, and

(ii) cost depletion had been used by the taxpayer with respect to such property for all taxable years.

(D) Section 263(c) costs. — For purposes of this paragraph, the term "section 263(c) costs" means intangible drilling and development costs incurred by the taxpayer which (by reason of an election under section 263(c)) may be deducted as expenses for purposes of this title (other than this paragraph). Such term shall not include costs incurred in drilling a nonproductive well.

(E) Election to capitalize qualified tertiary injectant expenses. —

(i) In general. — Any taxpayer may elect, with respect to any property, to capitalize qualified tertiary injectant expenses for purposes of this paragraph. Any such election shall apply to all qualified tertiary injectant expenses allocable to the property for which the election is made, and may be revoked only with the consent of the Secretary. Any such election shall be made at such time and in such manner as the Secretary shall by regulations prescribe.

(ii) Qualified tertiary injectant expenses. — The term "qualified tertiary injectant expenses" means any expense allowable as a deduction under section 193.

(4) Special rule for applying paragraph (3)(C) to certain transfers of proven oil or gas properties. —

(A) In general. — In the case of any proven oil or gas property transfer which (but for this subparagraph), would result in an increase in the amount determined under paragraph (3)(C) with respect to the transferee, paragraph (3)(C) shall be applied with respect to the transferee by taking into account only those amounts which would have been allowable with respect to the transferor under paragraph (3)(C) and those costs incurred during periods after such transfer.

(B) Proven oil or gas property transfer. — For purposes of subparagraph (A), the term "proven oil or gas property transfer" means any transfer (including the subleasing of a lease or the creation of a production payment which gives the transferee an economic interest in the property) after 1978 of an interest (including an interest in a partnership or trust) in any proven oil or gas property (within the meaning of section 613A(c)(9)(A)).

(5) Special rule where there is production payment. — For purposes of paragraph (2), if any portion of the taxable crude oil removed from the property is applied in discharge of a production payment, the gross income from such portion shall be included in the gross income from the property of both the person holding such production payment and the person holding the interest from which such production payment was created.

(6) Cost recovery oil covered by net profits agreement. — For purposes of paragraph (2), if any person is treated under section 4996(a)(1)(B) as the

producer of any portion of the cost recovery oil covered by a net profits agreement (within the meaning of section 4996(h)) —

(A) such person (and only such person) shall include in his gross income from the property the gross income from such portion, and

(B) the qualified costs allocable to such portion shall be treated as paid or incurred by such person (and only by such person).

(c) Removal price. — For purposes of this chapter —

(1) In general. — Except as otherwise provided in this subsection, the term "removal price" means the amount for which the barrel is sold.

(2) Sales between related persons. — In the case of a sale between related persons (within the meaning of section 103(b)(6)(C)), the removal price shall not be less than the constructive sales price for purposes of determining gross income from the property under section 613.

(3) Oil removed from premises before sale. — If crude oil is removed from the premises before it is sold, the removal price shall be the constructive sales price for purposes of determining gross income from the property under section 613.

(4) Refining begun on premises. — If the manufacture or conversion of crude oil into refined products begins before such oil is removed from the premises —

(A) such oil shall be treated as removed on the day such manufacture or conversion begins, and

(B) the removal price shall be the constructive sales price for purposes of determining gross income from the property under section 613.

(5) Meaning of terms. — The terms "premises" and "refined product" have the same meaning as when used for purposes of determining gross income from the property under section 613.

§ 4989. Adjusted base price

(a) Adjusted base price defined. — For purposes of this chapter, the term "adjusted base price" means the base price for the barrel of crude oil plus an amount equal to —

(1) such base price, multiplied by

(2) the inflation adjustment for the calendar quarter in which the crude oil is removed from the premises.

The amount determined under the preceding sentence shall be rounded to the nearest cent.

(b) Inflation adjustment. —

(1) In general. — For purposes of subsection (a), the inflation adjustment for any calendar quarter is the percentage by which —

(A) the implicit price deflator for the gross national product for the second preceding calendar quarter, exceeds

(B) such deflator for the calendar quarter ending June 30, 1979.

(2) Additional adjustment for tier 3 oil. — The adjusted base price for tier 3 oil shall be determined

by substituting for the implicit price deflator referred to in paragraph (1)(A) an amount equal to such deflator multiplied by 1.005 to the nth power where "n" equals the number of calendar quarters beginning after September 1979 and before the calendar quarter in which the oil is removed from the premises.

(3) First revision of price deflator used. — For purposes of paragraphs (1)(A) and (2), the first revision of the price deflator shall be used. For purposes of applying paragraph (1)(B), the revision of the price deflator which is most consistent with the revision used for purposes of paragraph (1)(A) shall be used.

(c) Base price for tier 1 oil. — For purposes of this chapter, the base price for tier 1 oil is —

(1) the ceiling price which would have applied to such oil under the March 1979 energy regulations if it had been produced and sold in May 1979 as upper tier oil, reduced by

(2) 21 cents.

(d) Base prices for tier 2 oil and tier 3 oil. — For purposes of this chapter —

(1) General rule. — Except as provided in paragraph (2), the base prices for tier 2 oil and tier 3 oil shall be prices determined pursuant to the method prescribed by the Secretary by regulations. Any method so prescribed shall be designed so as to yield, with respect to oil of any grade, quality, and field, a base price which approximates the price at which such oil would have sold in December 1979 if —

(A) all domestic crude oil were uncontrolled, and

(B) the average removal price for all domestic crude oil (other than Sadlerochit oil) were —

(i) $15.20 a barrel for purposes of determining base prices for tier 2 oil, and

(ii) $16.55 a barrel for purposes of determining base prices for tier 3 oil.

(2) Interim rule. — For months beginning before October 1980 (or such earlier date as may be provided in regulations taking effect before such earlier date), the base prices for tier 2 oil and tier 3 oil, respectively, shall be the product of —

(A) (i) the highest posted price for December 31, 1979, for uncontrolled crude oil of the same grade, quality, and field, or

(ii) if there is no posted price described in clause (i), the highest posted price for such date for uncontrolled crude oil at the nearest domestic field for which prices for oil of the same grade and quality were posted for such date, multiplied by

(B) a fraction the denominator of which is $35, and the numerator of which is —

(i) $15.20 for purposes of determining base prices for tier oil, and

(ii) $16.55 for purposes of determining base prices for tier 3 oil.

For purposes of the preceding sentence, no price which was posted after January 14, 1980, shall be taken into account.

(3) Minimum interim base price. — The base price determined under paragraph (2) for tier 2 oil or tier 3 oil shall not be less than the sum of —

(A) the ceiling price which would have applied to such oil under the March 1979 energy regulations if it had been produced and sold in May 1979 as upper tier oil, plus

(B) (i) $1 in the case of tier 2 oil, or

(ii) $2 in the case of tier 3 oil.

§ 4996. Other definitions and special rules

(a) Producer and operator. — For purposes of this chapter —

(1) Producer. —

(A) In general. — Except as provided in subparagraphs (B) and (C), the term "producer" means the holder of the economic interest with respect to the crude oil.

(B) Net profits interests. —

(i) In general. — Except to the extent otherwise provided by regulations, in the case of any property, all cost recovery oil covered by a net profits agreement (within the meaning of subsection (h)) shall be treated as produced by the parties to such agreement in proportion to their respective shares (determined after reduction for such cost recovery oil) of the production of the crude oil covered by such agreement.

(ii) Clause (i) not to apply before payout. — In the case of any property, clause (i) shall only apply for —

(I) the first taxable period in which, under the agreement with respect to such property, one or more persons receives a share described in subsection (h) (1) (B), and

(II) all subsequent taxable periods to which such agreement applies.

(C)[1] Partnerships. —

(i) In general. — If (but for this subparagraph) a partnership would be treated as the producer of any crude oil —

(I) such crude oil shall be allocated among the partners of such partnership, and

(II) and partner to whom such crude oil is allocated (and not the partnership) shall be treated as the producer of such crude oil.

(ii) Allocation. — Except to the extent otherwise provided in regulations, any allocation under clause (i)(I) shall be determined on the basis of a person's proportionate share of the income of the partnership.

(C) Subchapter S corporations. —

(i) In general. — If (but for this subparagraph) an S corporation would be treated as a producer of any crude oil —

(I) such crude oil shall be allocated among the shareholders of such corporation, and

(II) any shareholder to whom such crude oil is allocated (and not the S corporation) shall be treated as the producer of such crude oil.

(ii) Allocation. — Except to the extent otherwise provided in regulations, any allocation under clause (i)(I) shall be determined on the

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[1]As in original. A second subparagaph (C) follows.

basis of the shareholder's pro rata share (as determined under section 1377(a) of the income of the corporation.

(2) Operator. —

(A) In general. — Except as provided in subparagraph (B), the term "operator" means the person primarily responsible for the management and operation of crude oil production on a property.

(B) Designation of other person. — Under regulations prescribed by the Secretary, the term "operator" means the person (or persons) designated with respect to a property (or portion thereof) as the operator for purposes of this chapter by persons holding operating mineral interests in the property.

(b) Other definitions. — For purposes of this chapter —

(1) Crude oil. — The term "crude oil" has the meaning given to such term by the June 1979 energy regulations. In the case of crude oil which is condensate recovered off the premises by mechanical separation, such crude oil shall be treated as removed from the premises on the date on which it is so recovered.

(2) Barrel. — The term "barrel" means 42 United States gallons.

(3) Domestic. — The term "domestic", when used with respect to crude oil, means crude oil produced from a well located in the United States or in a possession of the United States.

(4) United States. — The term "United States" has the meaning given to such term by paragraph (1) of section 638 (relating to Continental Shelf areas).

(5) Possession of the United States. — The term "possession of the United States" has the meaning given to such term by paragraph (2) of section 638.

(6) Indian tribe. — The term "Indian tribe" has the meaning given to such term by section 106(b)(2)(C)(ii) of the Natural Gas Policy Act of 1978 (15 U.S.C. 3316(b)(2)(C)(ii)).

(7) Taxable period. — The term "taxable period" means —

(A) March 1980, and

(B) each calendar quarter beginning after March 1980.

(8) Energy regulations —

(A) In general. — The term "energy regulations" means regulations prescribed under section 4(a) of the Emergency Petroleum Allocation Act of 1973 (15 U.S.C. 753(a)).

(B) March 1979 energy regulations. — The March 1979 energy regulations shall be the terms of the energy regulations as such terms existed on March 1, 1979.

(C) June 1979 energy regulations. — The June 1979 energy regulations —

(i) shall be the terms of the energy regulations as such terms existed on June 1, 1979, and

(ii) shall be treated as including final action taken pursuant thereto before June 1, 1979, and as including action taken before, on, or after

such date with respect to incremental production from qualified tertiary enhanced recovery projects.

(D) Continued application of regulations after decontrol. — Energy regulations shall be treated as continuing in effect without regard to decontrol of oil prices or any other termination of the application of such regulations.

(c) Severance tax adjustment. — For purposes of this chapter —

(1) In general. — The severance tax adjustment with respect to any barrel of crude oil shall be the amount by which —

(A) any severance tax imposed with respect to such barrel, exceeds

(B) the severance tax which would have been imposed if the barrel had been valued at its adjusted base price.

(2) Severance tax defined. — For purposes of this subsection, the term "severance tax" means a tax —

(A) imposed by a State with respect to the extraction of oil, and

(B) determined on the basis of the gross value of the extracted oil.

(3) Limitations. —

(A) 15 percent limitation. — A severance tax shall not be taken into account to the extent that the rate thereof exceeds 15 percent.

(B) Increases after March 31, 1979, must apply equally. — The amount of the severance tax taken into account under paragraph (1) shall not exceed

the amount which would have been imposed under a State severance tax in effect on March 31, 1979, unless such excess is attributable to an increase in the rate of the severance tax (or to the imposition of a severance tax) which applies equally to all portions of the gross value of each barrel of oil subject to such tax.

(d) Alaskan oil from Sadlerochit reservoir. — For purposes of this chapter —

(1) Removal price determined on monthly basis. — The removal price of Sadlerochit oil removed during any calendar month shall be the average of the producer's removal prices for such month.

(2) Sadlerochit oil defined. — The term "Sadlerochit oil" means crude oil produced from the Sadlerochit reservoir in the Prudhoe Bay oilfield.

(e) Special rules for post-1978 transfers of property. — In the case of a transfer after 1978 of any portion of a property, for purposes of this chapter (including the application of the June 1979 energy regulations for purposes of this chapter), after such transfer crude oil produced from any portion of such property shall not constitute oil from a stripper well property, newly discovered oil, or heavy oil, if such oil would not be so classified if the property had not been transferred.

(f) Adjustment of removal price. — In determining the removal price of oil from a property in the case of any transaction, the Secretary may adjust the removal price to reflect clearly the fair market value of oil removed.

(g) No exemptions from tax. — No taxable crude oil, and no producer of such crude oil, shall be exempt from the tax imposed by this chapter except to the extent provided in this chapter or in any provision of law enacted

after the date of the enactment of this chapter which grants a specific exemption, by reference to this chapter, from the tax imposed by this chapter.

(h) Terms used in subsection (a)(1)(B). — For purposes of subsection (a)(1)(B) and this subsection —

(1) Net profits agreement. — The term "net profits agreement" means an agreement entered into (or renewed) after March 31, 1982, and providing for sharing part or all of the production of crude oil from a property where —

(A) 1 or more persons are to be reimbursed for qualified costs by the allocation of cost recovery oil, and

(B) 1 or more persons are to receive a share of any production of crude oil from the property remaining after reduction for the cost recovery oil referred to in subparagraph (A).

(2) Cost recovery oil defined. — The term "cost recovery oil" means crude oil produced from the property which is allocated to a person as reimbursement for qualified costs paid or incurred with respect to the property. The Secretary shall by regulation prescribe rules for allocating the cost recovery oil to the oil produced from the property.

(3) Qualified costs. — The term "qualified costs" means any amount paid or incurred for exploring for, or developing or producing, 1 or more oil or gas wells on the property.

(4) Scope of agreement. — A net profits agreement shall be treated as covering only shares of production of crude oil held by persons who hold economic interests in the property (determined without regard to subsection (a)(1)(B).

(i) Cross reference. — For the holder of the economic interest in the case of a production payment, see section 636.

APPENDIX D

Crocker National Bank v. McFarland Energy, Inc., 140 Cal.App.3d 6, 189 Cal.Rptr. 302 (1983) (hearing denied)

CROCKER NATIONAL BANK, ETC., ET AL.,
PLAINTIFFS AND RESPONDENTS,

v.

MCFARLAND ENERGY, INC., A CALIFORNIA CORPORATION

DEFENDANT AND APPELLANT.

Civ. 65632.

Court of Appeal, Second District, Division 4.

Feb. 17, 1983.
Hearing Denied April 27, 1983.

AMERIAN, Associate Justice.

In 1965 Joseph M. Thomas conveyed certain property to a trust he had created two years before for the benefit of his children. The instrument was entitled, "Conveyance Of Perpetual, Expense And Deduction Free Royalty." The property in question was a one-sixth interest in oil, gas and other hydrocarbon substances produced from described real estate in Kern County.

The conveyance included paragraph 7 requiring grantor to pay certain taxes. That paragraph contained the following provision:

> "Grantor shall pay and discharge before delinquency all taxes, assessments and other governmental charges upon or referable to any operations or

acts of Grantor or on Grantor's behalf on Said Lands, including (without limiting the generality of the foregoing) the drilling or operation of any well or wells, the production, extraction, severance or removal of any hydrocarbon, the processing, storage or use thereof, the sale of any such hydrocarbon or of any product thereof, or the transportation thereof away from Said Lands. Grantor shall also pay and discharge before delinquency any and all assessments, charges and obligations of any kind which by reason of any operator of Grantor may be or might become a lien upon or charge against Said Lands or any part thereof or any well thereon or production therefrom, and which are created by or shall arise under or by reason of any present or future law, ordinance, regulation or order whatever, including (without limiting the generality of the foregoing) any charge, assessment, claim or obligation created by or arising under the California Public Resources Code or any act amendatory thereof or supplemental or additional thereto."

The conveyance also provided in another paragraph, "It is the purpose and intent of this conveyance of royalty that it shall (except as specifically set forth herein) be free and clear of all expenses and deductions of every kind and nature, all of which expenses shall be paid by or for the account of Grantor and shall be without any reimbursement by Grantee."

Appellant McFarland Energy, Inc. (herein appellant) succeeded to the interest of Joseph M. Thomas in 1974. Respondents Crocker National Bank and R.A. Ganong (herein respondents) are the trustees of the trust.

In 1980 the U.S. Congress enacted a "Windfall Profit Tax." (26 U.S.C.A. § 4986 et seq.) Section 4986 provides,

"Imposition of tax. [¶] (a) Imposition of tax—An excise tax is hereby imposed on the windfall profit from taxable crude oil removed from the premises during each taxable period. [¶] (b) Tax paid by producer.—The tax imposed by this section shall be paid by the producer of the crude oil."

Shortly after the tax became effective, appellant and respondents engaged in correspondence over the question of which should bear the burden of the tax. Thereafter, respondents filed this action for declaratory relief. The matter was tried on stipulated facts.

The trial court ruled,

"1. Under the terms of the Expense and Deduction Free Royalty (Plaintiffs' Exhibit 'A'), Defendant McFarland Energy, Inc., as successor in interest to the grantor, is obligated to pay Plaintiffs' 'royalty share' (as defined in Exhibit 'A') without deduction for the tax imposed by Internal Revenue Code Sections 4986, et seq., commonly referred to as the Windfall Profits [sic] Tax.

"2. Plaintiffs are awarded judgment in the amount of $153,427.67, for amounts improperly withheld from Plaintiffs' royalty share through April 20, 1981, $7,659.56, a total judgment of $161,087.23, [sic] interest on said amount and costs in the amount of $51.00."

The appeal is from that judgment.

ISSUE

Is the Windfall Profit Tax a tax, assessment or charge upon or referable to any operations or acts of appellant on the land, within the meaning of paragraph 7 of the conveyance?

DISCUSSION

In the language of the statute, Windfall Profit Tax is a tax "imposed on the windfall profit from taxable crude oil removed from the premises." Thus, as oil is removed and sold, a tax is imposed on the revenue realized. The tax is to "be paid by the producer of the crude oil." 26 U.S.C.A. § 4986(b).

Producer is defined as follows, "Except as provided in subparagraph (B),[1] the term 'producer' means the holder of the economic interest with respect to crude oil." (26 U.S.C.A. § 4996(a)(1)(A).)

The tax is calculated by referring to the amount for which the oil is sold. (26 U.S.C.A. § 4988(c)(1).)

Under the conveyance in question, who is the holder of the economic interest with respect to the crude oil? It seems to us that respondents hold that interest as to one-sixth of the oil and therefore are responsible under the conveyance for one-sixth of the tax. The conveyance provides that what is being conveyed is 16⅔ percent of all oil, gas and other hydrocarbon substances. Under the conveyance respondents "have the option to receive royalty oil either in kind or in money." The product thus belongs to respondents as it is produced by appellant. It would be respondents' free of windfall profit tax only if the tax was of the kind required under the conveyance to be paid by appellant. (*Transport Oil Co. v. Bush* (1931) 114 Cal.App. 152, 160, 1 P.2d 1060.)

The conveyance under scrutiny imposes certain conditions which must be met before a tax is required to be borne by appellant. The tax must be referable to acts or

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[1]This subparagraph deals with partnerships.

operations of appellant. Those acts must occur on the property in question.

The Windfall Profit Tax does not meet these requirements. It is not referable to any act on the property in question.

Respondents argue that the Windfall Profit Tax is really a severance tax. Their theory is that the tax is imposed on the removal of the oil. But that is not what the statute says. The reference in 26 U.S.C.A., section 4986(a) to "oil removed from the premises during each taxable period" simply is inserted for purposes of knowing when the tax is imposed. If the oil is removed in this taxable year, regardless of the taxable year in which the sale is made.

The statute imposes an excise tax on profit and furnishes the mechanics by which the profit and the tax are to be calculated. Had Congress desired to impose a tax on removal, other language would have been used. Then, no reference to profit, windfall or otherwise, would have been required. Such a tax would have been imposed based on the number of barrels produced.

There is on dispute that the parties to an oil lease may provide any basis they wish for division of tax expenses. (47 Cal.Jur.3d, Oil and Gas, § 47.) Here the basis is that the tax must be referable to acts or operations of appellant on the property. The Windfall Profit Tax, as we read it, is referable to the *revenue generated from sales.* As such it is not included within paragraph 7 of the conveyance.

DISPOSITION

The judgment is reversed.

KINGSLEY, Acting P.J., and WISOT*, J., concur.

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* Assigned by the Chairperson of the Judicial Council.

APPENDIX E

Mobil Oil Corp. v. City of Long Beach, 578 F.Supp. 1197 (C.D. Cal. 1984) (appeals pending)

MOBIL OIL CORPORATION,
PLAINTIFF,
V.
CITY OF LONG BEACH,
a Municipal Corporation,
DEFENDANT.

SHELL OIL COMPANY,
PLAINTIFF,
V.
CITY OF LONG BEACH,
ET AL.,
DEFENDANTS.

TEXACO, INC.
PLAINTIFF
V.
CITY OF LONG BEACH,
DEFENDANT.

EXXON CORPORATION,
PLAINTIFF,
V.
CITY OF LONG BEACH,
DEFENDANT.

UNION OIL COMPANY OF CALIFORNIA,
PLAINTIFF,
V.
CITY OF LONG BEACH,
ET AL.,
DEFENDANTS.

STATE OF CALIFORNIA
and THE CITY OF LONG BEACH,
PLAINTIFFS,
v.
TEXACO, INC., ET AL.,
DEFENDANTS.

Nos. CV 83-6424-WPG, CV 83-6467-WPG, CV 83-6471-WPG, CV 83-6494-WPG, CV 83-6554-WPG and CV 83-7303-WPG.

United States District Court,
C.D. California.

Jan. 17, 1984.

MEMORANDUM OF DECISION

WILLIAM P. GRAY, District Judge.

For purposes of this Memorandum, this somewhat simplified recital of facts is believed sufficient. In 1965 plaintiffs Mobil, Shell, Texaco, Exxon and Union ("the oil companies") jointly entered into a "Contractors' Agreement" with the City of Long Beach. Under this agreement, the oil companies have the right and obligation to produce oil from certain properties owned by Long Beach, purchase the oil so produced at prices dictated by the Contractors' Agreement, deduct from the purchase price the expenses of production listed or described in the agreement, and divide with Long Beach the remaining "net profit." The parties have been operating under this contract ever since its execution.

In 1980, Congress enacted the "Windfall Profit Tax on Domestic Crude Oil," 26 U.S.C. § 4986 *et seq.*, which imposed upon the producer of the crude oil "An excise tax . . . on the windfall profit from taxable crude oil removed from the premises during each taxable period." *Id.* § 4986.

The plaintiff companies, in computing the net profit to be shared with Long Beach, have been deducting as expenses the Windfall Profit Taxes paid by them. Long Beach contends that they are not entitled to do so under the Contractors' Agreement. After some negotiation in attempt to resolve the matter, Long Beach, on October 13, 1983, filed an action in California Superior Court that seeks, among other things, to recover from the oil companies the additional net profit that it would have received but for such deductions. The oil companies, defendants in that action, have caused it to be removed to this court, where it bears No. CV 83-7303-WPG ("the State action"). A few days before the State action was filed, each of the oil companies filed in this court a separate complaint seeking a declaratory judgment to the effect that such company has properly charged its Windfall Profit Tax payments against its net profits account.

Long Beach has moved for dismissal of the five actions brought by the oil companies. Such motion will be granted for reasons stated in this Memorandum. For the same reasons, the State action will be remanded to the California Superior Court. In view of these rulings, this court declines to act upon the oil companies' motions for summary judgment in their respective cases.

1. *Substantial Federal Question.*

The first issue here raised by the parties is whether this court has subject matter jurisdiction under 28 U.S.C. § 1331. "Congress has given the lower federal courts jurisdiction to hear, originally or by removal from a state court, only those cases in which a well-pleaded complaint establishes either that federal law creates the cause of action or that the plaintiff's rights to relief necessarily depends on resolution of a substantial question of federal law." *Franchise Tax Board v. Laborers Vacation Trust,*

___ U.S. ___, ___, 103 S.Ct. 2841, 2856, 77 L.Ed.2d 420, 442 (1983). The plaintiffs do not assert that the Windfall Profit Tax statute creates a cause of action, and I find no substantial federal question here.

A. *Interpretation Of The Windfall Profit Tax.*

The oil companies insist that the Contractors' Agreement includes excise taxes in the list of proper charges against net profit and that the only task for the court is to interpret the Windfall Profit Tax to determine whether it imposes an excise. On the other hand, Long Beach acknowledges, as it must, that the subject statute, in its very words, does impose an excise tax. According to Long Beach, the question for the court is whether or not the terms of the Contractors' Agreement and the manner in which the oil companies have operated under it justify treating the subject tax as a deductible expense in computing net profits. As counsel for Long Beach asserted at the hearing on the motion to dismiss, "What we are arguing is that under the contract, after they have paid the tax, how they account for it within the terms of that contract." (Transcript, p. 54, lines 18-20). Long Beach's side of the argument is set out at paragraph 20 of its complaint (in Case No. 83-7303-WPG):

> The City and the State contend that under the terms of the Contractors' Agreement . . ., windfall profit taxes are not proper charges to the contractors' net profits account. In other words, windfall profit taxes are not the type of costs incurred by the contractors that the contracts contemplate to be reimbursable to them so as to reduce net profits.

It is true, as counsel for Shell has pointed out, that paragraph 28 of the Long Beach complaint asserts that "The windfall profit tax is in the nature of a profits tax.

. . ." But the paragraph goes on to argue that under the terms of the Contractors' Agreement its payment is not chargeable to the contractors' net profits accounts. Long Beach thus contends that the document that needs interpretation is not the Windfall Profit Tax statute but, instead, it is the Contractors' Agreement.

Long Beach therefore argues that the plaintiff oil companies are creating a non-existent controversy over the meaning of the statute and using this, in effect, as a defense to a state-law controversy over the contract language. I agree.

Skelly Oil Co. v. Phillips Petroleum Co., 339 U.S. 667, 70 S.Ct. 876, 94 L.Ed.2d 1194 (1950), teaches that "if but for the availability of the declaratory judgment procedure, the federal claim would arise only as a defense to a state created action, jurisdiction is lacking." 10A C. Wright, A. Miller & M. Kane, FEDERAL PRACTICE & PROCEDURE, § 2767 at 744-45 (2d ed. 1983) (quoted in *Franchise Tax Board v. Construction Laborers Vacation Trust*, ___ U.S. ___, ___, 103 S.Ct. 2841, 2850, 77 L.Ed.2d 420, 435 (1983). *See also Public Service Commission of Utah v. Wycoff Co.*, 344 U.S. 237, 248, 73 S.Ct. 236, 242, 97 L.Ed. 291 (1950) ("Where the complaint in an action for declaratory judgment seeks in essence to assert a defense to an impending or threatened state court action, it is the character of the threatened action, and not of the defense, which will determine whether there is federal-question jurisdiction . . .") (dictum); *Alton Box Board Co. v. Esprit de Corp*, 682 F.2d 1267, 1274 (9th Cir.1982) ("A claim does not arise under federal law within the meaning of section 1331 where it relies on federal law only to establish an immunity or defense

which would preclude the declaratory judgment defendant from successfully litigating against the declaratory judgment plaintiff a claim arising under state law.")

It is clear that the real controversy between the parties concerns the contract language. In light of the foregoing, I conclude that no substantial federal question is raised in the oil companies' complaints.

B. *Alleged Fourteenth Amendment Violation.*

Shell contends that in challenging or threatening to sue the oil companies for having deducted the subject taxes in computing net profits, the City and State "... took arbitrary state action to impair Shell's property interest under the Contractors' Agreement." (Shell memorandum in opposition, in Case No. 83-6467-WPG, p. 16). I believe that such a contention borders on the frivolous. Long Beach and the State have taken nothing. To the contrary, Long Beach is seeking a judicial determination that it has a right to more money than the oil companies have accorded it pursuant to their contractual obligations. This issue simply involves a dispute over a contract. Whether Long Beach is correct or not in its contention, it is acting in full accordance with due process of law.

Inasmuch as the controversy involved in this litigation presents no substantial federal question arising either under the Constitution or a statute, section 1331 does not provide jurisdiction for this court.

II. *Diversity Jurisdiction and Rule 19, Fed.R.Civ.P.*

The only other basis upon which this court might have jurisdiction is diversity, under 28 U.S.C. § 1332. *Union* is a California corporation, and its complaint must therefore be dismissed. Mobil, Shell, Texaco and Exxon are incorporated and have their principal places of business in

other states and therefore are diverse. However, these five oil companies jointly entered into the Contractors' Agreement with Long Beach, and the question arises as to whether the joinder of all of them in any one of the individual actions is "needed for just adjudication" within the meaning of Rule 19 of the Federal Rules of Civil Procedure.

Certainly, each of the oil companies "... claims an interest relating to the subject of the action. ..." I think it also true that any one of the companies that might not be able to participate in this litigation would be impeded in its "... ability to protect that interest. ..." Of course the companies that have diversity are all before this court and their respective cases readily could be consolidated. The joinder of Union would destroy diversity and thus deprive this court of jurisdiction. This fact, under the command of subsection "(b)" of Rule 19, requires that this court "... determine whether in equity and good conscience the action should proceed among the parties before it, or should be dismissed, the absent person being thus regarded as indispensable." In pondering this question, the court is mindful that Union has submitted an authoritative affidavit in which it agrees to be bound by a final judgment in Shell's case (No. 83-6467-WPG) if the need for diversity jurisdiction must preclude Union's proceeding in this court. Shell California Production Inc. and Pauley Petroleum Inc., both of whom might be considered indispensable and whose presence would destroy diversity, have submitted similar undertakings. In view of the dispositive action contemplated by the court, I refrain at this time from making a firm decision as to whether or not the Rule 19 problem is solved completely.

However, in light of the foregoing, and inasmuch as simultaneous actions by or against Union and Shell California Production Inc. and Pauley Petroleum Inc. in state court are available, I would normally be disposed to proceed with the diverse parties and not regard the three absent companies as indispensable. However, the reasons for my declining to proceed in these actions are set out in the remainder of this Memorandum.

III. *Principle of "Wise Judicial Administration".*

The issue of the proper computation of net profits under the Contractors' Agreement, in light of the Windfall Profit Tax, was first raised by Long Beach. Long Beach sought to resolve the matter by negotiation with the oil companies. When that failed, the city expressed its intention to litigate the issue in state court and promptly filed the action that the defendants removed here (Case No. 83-7303-WPG). All of the five oil companies, as well as Shell California Production Inc. and Pauley Petroleum Inc., are named in that action and, as is noted above, it seeks damages for alleged underpayment to Long Beach of net profits.

For reasons best known to themselves, the five defendant oil companies and Shell California Production Inc. preferred to be in federal court. They knew that the action that Long Beach was about to file could not be removed on the ground of diversity. Presumably, they also were doubtful of establishing "federal question" jurisdiction under section 1331. So they hurriedly prepared and filed the individual actions that we now confront, thus raising in six separate proceedings, which were assigned to six separate judges, the very issue that is embodied in the single Long Beach action filed in state court. Subsequently, pursuant to interior policies of this district court, five of the judges took the time to give consideration to

their respective matters and, as a matter of individual discretion, caused them to become my responsibility. A sixth action, filed by Shell California Production Inc., has been dismissed by the plaintiff.

I already have expressed the conclusion that this court does have diversity jurisdiction over the four diverse oil company cases. I also am thoroughly mindful of the admonition expressed by Justice Brennan in *Colorado River Water Conservation District, et al., v. United States*, 424 U.S. 800, 813, 96 S.Ct. 1236, 1244, 47 L.Ed.2d 483 (1976):

> Abstention from the exercise of federal jurisdiction is the exception, not the rule. "The doctine of abstention, under which a District Court may decline to exercise or postpone the exercise of its jurisdiction, is an extraordinary and narrow exception to the duty of a District Court to adjudicate a controversy properly before it. Abdication of the obligation to decide cases can be justified under this doctrine only in the exceptional circumstances where the order to the parties to repair to the State court would clearly serve an important coutervailing interest." *County of Allegheny v. Frank Mashuda Co.*, 360 U.S. 185, 188-189, 3 L.Ed.2d 1163, 79 S.Ct. 1060 [1062-1063] (1959).

However, Justice Brennan also stated that there are "... circumstances permitting the dismissal of a federal suit due to the presence of a concurrent state proceeding for reasons of wise judicial administration ...." 424 U.S. at 818, 96 S.Ct. at 1246. I believe that such circumstances are present in these cases, for the following reasons:

1. As is stated earlier in this Memorandum, the State action filed by Long Beach could not properly have been removed to this court, and the oil companies sought to

solve that problem by bringing declaratory relief actions through which they proposed to litigate the same issue as that raised in the State action. Much the same thing happened in the remarkably similar case of *Shell Oil Company v. Frusetta,* 290 F.2d 689 (9th Cir.1961). Our Court of Appeals affirmed the district judge in having dismissed the declaratory judgment action because he "... felt this action was nothing more than an attempt to use the Declaratory Judgment Act, 28 U.S.C.A. § 2201 *et seq.,* as a device to remove a nonremovable dispute from the state courts, and that granting such declaratory judgments 'would in many respects evade the purpose and intent of the Removal Act [28 U.S.C.A. § 1441 *et seq.*].' " 290 F.2d at 691. The opinion of the Court of Appeals went on to state:

> It is not the purpose of the Declaratory Judgment Act to allow disputes arising in the course of state court litigation to be argued in the federal courts instead. "The object of the statute is to afford a new form of relief where needed, not to furnish a new choice of tribunals or to draw into the federal courts the adjudication of causes properly cognizable by courts of the states."

290 F.2d at 692.

2. The "race to the courthouse" that was involved here is troublesome. *Colorado River Water Conservation District v. United States,* 424 U.S. 800, 818, 96 S.Ct. 1236, 1246, 47 L.Ed.2d 483 (1976), teaches that "In assessing the appropriateness of dismissal in the event of an exercise of concurrent jurisdiction, a federal court may also consider such factors as ... the order in which jurisdiction was obtained by the concurrent forums, ..." Here, the oil companies filed their actions in this court a few days before Long Beach instituted its state court case.

But the oil companies knew that it was coming and hurried to get theirs on file first. I quote once again from *Shell Oil Company v. Frusetta,* 290 F.2d 689, 692 (9th Cir.1961):

> The mere fact that Shell succeeded in filing its complaint in the federal court three days before appellees filed their motions in the state court does not automatically entitle Shell to a federal declaratory judgment hearing. *Kerotest Mfg. Co. v C-O-Two Co.,* 1951, 342 U.S. 180, 72 S.Ct. 219, 96 L.Ed. 200. It is not the purpose of the Declaratory Judgment Act to encourage a race to the courthouse for the purpose of transferring litigation to the federal courts from the state courts. The purpose of the Declaratory Judgment Act is to afford an added remedy to one who is uncertain of his rights and who desires an early adjudication thereof without having to wait until his adversary should decide to bring suit, and to act at his peril in the interim. *Aetna Casualty & Surety Co. v. Quarles,* 4 Cir., 1937, 92 F.2d 321; *Berlitz School of Languages v. Donnelly & Suess,* D.C.E.D.Pa.1949, 84 F.Supp. 75. Shell was in no such situation. Its adversary had announced in open court that it was going to bring these same issues before the state court, which it promptly proceeded to do.

The above comments are equally applicable here. The oil companies have had and still have ample and timely opportunity to litigate the subject issue in the State action. For purposes of balancing the factors for and against abstention by this court, I am considering the matter as though the State action had been filed first.

3. The comments in the preceding paragraph bring this case reasonably close to a *Younger v. Harris* situation, which the opinion in *Colorado River* stated was one of the circumstances that would justify federal abstention. 424 U.S. at 816, 96 S.Ct. at 1245. Of course, in *Younger* the state action involved a criminal prosecution. However, *Juidice v. Vail*, 430 U.S. 327, 97 S.Ct. 1211, 51 L.Ed.2d 376 (1977), held that the principles of *Younger* are applicable to appropriate civil actions. In that case, Vail was a judgment debtor in New York. He brought a civil rights action in federal court under 42 U.S.C. § 1983, in which he sought damages growing out of his having been held in contempt and jailed for having ignored subpoenas to appear at supplemental proceedings against judgment debtors pursuant to a state statute that he urged the federal court to declare unconstitutional. In rendering the opinion of the Court, Justice Rehnquist observed that Vail had had an opportunity to present his federal claims in the state proceedings and that "No more is required to invoke Younger abstention." 430 U.S. at 337, 97 S.Ct. at 1218.

Likewise, in the instant matters, the oil companies had ample opportunity to present their contentions in the state proceedings. Instead, they filed new actions here that not only sought declaratory relief, but three of them (Texaco, Mobil and Union) asked for injunctions that would restrain Long Beach from proceeding in state court. Although *Juidice* is distinguishable from this litigation in several ways, I think that the quotation from *Younger,* upon which Justice Rehnquist relied, has some pertinence here:

> As we emphasized in Huffman, the " 'more vital consideration' " behind the Younger doctine of non-intervention lay not in the fact that the state criminal process was involved but rather in
>
> > " 'the notion of "comity," that is, a proper respect for state functions, a recognition of the fact that the entire country is made up of a Union of separate state governments, and a continuance of the belief that the National Government will fare best if the States and their institutions are left free to perform their separate functions in their separate ways.' " *Huffman* [*v. Pursue, Ltd.*], 420 U.S. [592] at 601, 43 L.Ed.2d 482, 95 S.Ct. 1200 [at 1206], quoting *Younger,* 401 U.S. at 44, 27 L.Ed.2d 669, 91 S.Ct. 746 [at 750].

430 U.S. at 334, 97 S.Ct. at 1216.

4. Finally, the opinion in *Shell Oil Company v. Frusetta,* 290 F.2d 689, 691 (9th Cir.1961) stated that "It is well established that even though jurisdiction may exist under the Declaratory Judgment Act the granting of declaratory judgments is at the discretion of the district court [citing cases]. Said discretion is to be exercised in accordance with sound judicial principles and the purposes of the Declaratory Judgment Act." After giving all of the consideration to these principles and purposes of which I am capable, I exercise such discretion and elect to dismiss the action brought by the oil companies.

For the reasons stated in this Memorandum, and on the court's own motion, the State action will be remanded to the Los Angeles County Superior Court.

JUDGMENT

For reasons stated in the Memorandum of Decision filed on this date, IT IS ADJUDGED that:

1. The complaints and actions in the following listed cases are ordered dismissed: CV 83-6424-WPG, CV 83-6467-WPG, CV 83-6471-WPG, CV 83-6494-WPG and CV 83-6554-WPG.

2. Case No. CV 83-7303-WPG, on the court's own motion, is ordered remanded to the Los Angeles County Superior Court.

The City of Long Beach is entitled to its costs in each of the foregoing actions.

APPENDIX F

Shell California Production, Inc. v. City of Long Beach, No. 83-6466-R (C.D.Cal.March 20, 1984) (judgment and statement of uncontested facts and conclusions of law) (appeal pending)

SHELL CALIFORNIA PRODUCTION INC.
PLAINTIFF,
V.
CITY OF LONG BEACH, et al.,
DEFENDANTS.

Civil Action No. 83-6466-R
UNITED STATES DISTRICT COURT
C.D. CALIFORNIA

JUDGMENT

ENTERED MARCH 20, 1984

MANUEL L. REAL, DISTRICT JUDGE

Plaintiff Shell California Production Inc.'s motion for summary judgment pursuant to Rule 56 of the Federal Rules of Civil Procedure having been heard, and it appearing to this Court that no genuine issue as to any material fact exists and that Shell California Production Inc. is entitled to summary judgment as a matter of law.

IT IS ORDERED that the Motion of Shell California Production Inc. for Summary Judgment is hereby granted;

IT IS FURTHER ORDERED that, since the Windfall Profit Tax on Domestic Crude Oil, 26 U.S.C. §§ 4986-4998, as amended, is an excise or severance tax and is not in the nature of an income or profits tax, Shell California Production Inc. has not violated the Contractors' Agreement between the parties by charging Windfall Profit Tax

payments to the Net Profits Account established by the contract;

IT IS FURTHER ORDERED that Long Beach is permanently enjoined from declaring Shell California Production Inc. in default of the Contractors' Agreement on the ground that charging Windfall Profit Tax payments to the Net Profits Account is in violation of the contract; and

IT IS FURTHER ORDERED that plaintiff Shell California Production Inc. is hereby awarded costs and reasonable attorneys' fees.

/s/ MANUEL L. REAL
United States District Judge

Dated: March 19, 1984

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SHELL CALIFORNIA PRODUCTION INC.
PLAINTIFF,
V.
CITY OF LONG BEACH, et al.,
DEFENDANTS.

Civil Action No.83-6466-R
UNITED STATES DISTRICT COURT
C.D. CALIFORNIA

STATEMENT OF UNCONTESTED FACTS AND CONCLUSIONS OF LAW

1. This Court has jurisdiction over this case pursuant to 28 U.S.C. § 1331.

2. Although defendants have identified issues of law, they have raised no genuine issue as to any material fact in this case.

3. Plaintiff Shell California Production Inc. ("SCPI") and defendant City of Long Beach ("Long Beach") are parties to a contract entitled Contractors' Agreement, Long Beach Unit, Wilmington Oil Field, California ("Contractors' Agreement").

4. The Contractors' Agreement is clear on its face, and contains no ambiguities with respect to the issues material to this controversy. If any ambiguity did exist, it would be construed against Long Beach, which prepared and presented the contract for public bids on a "take it or leave it" basis.

5. Articles 4 and 18 of the Contractors' Agreement establish a Net Profits Account for each Contractor and set forth the allowable charges and credits to such Accounts.

6. The terms "excise taxes," "severance taxes," "income taxes," and "profit taxes" are not defined in the Contractors' Agreement, nor do they have any "special meaning" to be determined by reference to the Contractors' Agreement. Moreover, a "special meaning" will not be imparted to these terms by review of conduct of the parties or other Agreements not before this Court.

7. The Contractors' Agreement allows SCPI to charge all excise or severance taxes to the Net Profits Account.

8. Shell Oil Company ("Shell"), together with Texaco Inc., Humble Oil & Refining Company (now Exxon Corporation), Union Oil Company of California and Mobil Oil Corporation formed a joint venture to bid on the Field Contractor's interest in Tract 1 of the Wilmington Field. These companies submitted the highest bid and were awarded the contract.

9. On March 2, 1965, the Contractors' Agreement between Long Beach and the companies comprising the Field Contractor was signed and ratified.

10. The Windfall Profit Tax, 26 U.S.C. §§ 4986-4998, as amended, is an excise or severance tax. The Windfall Profit Tax is not a tax on income or profits, nor is it in the nature of a tax on income or profits. The Act was retroactive to February 29, 1980, effective March 1, 1980. The Act imposes a tax on each barrel of domestic crude oil removed from the premises after February 29, 1980.

11. The relevant statutory language in 26 U.S.C. § 4986(a) (Supp. V 1981) plainly characterizes the Windfall Profit Tax as an excise tax.

12. The legislative history underlying the Windfall Profit Tax Act shows that Congress intended the Windfall Profit Tax to be an excise or severance tax not in the nature of an income or profits tax.

13. The procedural methods used by SCPI to make its Windfall Profit Tax payments were dictated by the Windfall Profit Tax Act itself, and in no way altered the character of the Windfall Profit Tax as an excise or severance tax not in the nature of an income or profits tax for purposes of this case.

14. Effective June 1, 1982, Shell, with Long Beach's knowledge and consent, transferred and assigned to SCPI, a wholly-owned subsidiary of Shell, all of its interest under the Contractors' Agreement. Shell guaranteed all monetary payments due Long Beach from SCPI.

15. SCPI, from June 1, 1982 forward, has charged the amounts of its Windfall Profit Tax payments attributable to its net profits share to the appropriate Net Profits Account. SCPI has paid approximately $1,000,000 in windfall profit taxes on oil allocated to it from Tract 1 of the Wilmington Field and charged that amount to the Net Profits Account. SCPI is continuing to charge approximately $55,000 in Windfall Profit Tax payments to the Net Profits Account each month.

16. Under California law, the contemporaneous construction of a statute by the administrative official or agency charged with its enforcement or interpretation is entitled to great weight and will be followed unless clearly erroneous. The California Franchise Tax Board is charged by California law with the interpretation of a variety of tax statutes, including those comprising the Windfall Profit Tax Act. The California Franchise Tax Board has found that the Windfall Profit Tax is deductible under California law and, therefore, is not an income or profits tax.

17. No violation of the Contractor's Agreement occurred by charging Net Profits Accounts with windfall profit tax payments.

IT IS SO ORDERED

Dated: March 19, 1984

/s/ MANUEL L. REAL
United States District Judge

APPENDIX C

New Mexico v. Regan, 745 F.2d 1318 (10th Cir. 1984) (transferred to Ct. Cl.), *cert. denied*, 105 S.Ct. 2138 (1985)

STATE OF NEW MEXICO,
PLAINTIFF-APPELLEE.

v.

DONALD T. REGAN, ETC.,
DEFENDANT/APPELLANT.

No. 83-1981.

United States Court of Appeals,
Tenth Circuit.

Oct. 9, 1984.

Before HOLLOWAY, SETH and BARRETT, Circuit Judges.

BARRETT, Circuit Judge.

This case involves the interplay of two federal statutes, the Mineral Lands Leasing Act of 1920, 30 U.S.C. §§ 181 *et seq.*, and the Crude Oil Windfall Profits Tax Act of 1980, 26 I.R.C. §§ 4986 *et seq.* The Mineral Lands Leasing Act (Mineral Act) directs the Secretary of the Treasury to pay fifty percent (50%) of all mineral royalties received from federal lands to the states in which the leased federal lands are located. Pursuant to the Crude Oil Windfall Profits Tax Act (COWPTA), however, these same federal royalties are subject to a federal tax. The question is thus raised whether the United States should impose the windfall profits tax on federal royalties before or after it computes the 50% share of the royalties owed to the states.

Donald T. Regan, Secretary of the Treasury of the United States, has taken the position that the states' shares must be calculated *after* deducting the windfall profits tax, and has in fact calculated the states' shares by this method since the passage of COWPTA in 1980. Taking the contrary position, the State of New Mexico brought the present action against Regan in 1981 claiming that the Mineral Act requires payment to the states of 50% of federal royalties undiluted by the windfall profits tax. New Mexico consequently sought to recover 50% of the federal royalties used to pay the windfall profits tax, together with interest, an accounting, declaratory relief, and its attorney fees. The district court granted New Mexico's motion for summary judgment, awarding completely the state's requested relief.

Secretary Regan appeals from this decision, asserting that the court's position is contrary to the intent of Congress in passing COWPTA and the Mineral Act. In addition, he argues that even if the court properly construed the applicable statutes, it erred in awarding the states prejudgment interest on the royalties withheld. Finally, Secretary Regan contends that because this is a suit against the United States to which it has not consented, the district court lacked jurisdiction to entertain New Mexico's suit. We will begin with an analysis of the jurisdictional issue.

The District Court's Jurisdiction

It is unclear from the district court's opinion whether it considered New Mexico's suit to be an action against the United States. The court did hold, however, that if such were the case the district court nonetheless possessed jurisdiction by virtue of 28 U.S.C § 1331, 5 U.S.C. §§ 701 *et seq.* (the Administrative Procedure Act), 28 U.S.C.

§ 1361 (federal mandamus), and 28 U.S.C. § 2201 (declaratory judgment). According to the court, these statutes granted the United States' consent to suit in the district court.

As an initial matter, we hold that New Mexico's suit is indeed an action against the United States. Although Secretary Regan is the nominal defendant in the suit, sovereign immunity is determined not by the party named as the defendant, but by the issues presented and the effect of the judgment. *Transwestern Pipeline Co. v. Kerr-McGee Corp.*, 492 F.2d 878, 844 (10th Cir.1974) *cert. dismissed* 419 U.S. 1097, 95 S.Ct. 691, 42 L.Ed.2d 689 (1975). If the relief sought against a federal officer in fact operates against the sovereign, then the action must be deemed as one against the sovereign. *Hawaii v. Gordon*, 373 U.S. 57, 58, 83 S.Ct. 1052, 1052-53, 10 L.Ed.2d 191 (1963).

New Mexico correctly points out that an exception to this general rule is recognized when a suit is brought against a governmental official challenging his or her *ultra vires* actions. *See Larson v. Domestic & Foreign Corp.*, 337 U.S. 682, 689, 69 S.Ct. 1457, 1461, 93 L.Ed. 1628 (1949). Assuming arguendo that this exception could be properly invoked in the present case,[1] the Supreme Court has rejected its application when "the relief

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[1]In our view it is doubtful that Secretary Regan's method of computing the states' royalties could be deemed *ultra vires*. New Mexico's challenge does not accurately rest upon the Secretary's lack of *delegated power* to determine the state's royalty, but rather that the Secretary's decision was *incorrect* as a matter of law. The Supreme Court has rejected such arguments asserted in the attempt to avoid the shield of sovereign immunity, and has held that actions of an officer within his *statutory authority* are the actions of the sovereign. *Larson v. Domestic & Foreign Corp.*, 337 U.S. 682, 693-95, 69 S.Ct. 1457, 1463-64, 93 L.Ed. 1628 (1949).

requested cannot be granted by merely ordering the cessation of the conduct complained of but will require affirmative action by the sovereign or the disposition of unquestionably sovereign property." *Id.* at 691 n. 11, 69 S.Ct. at 1462 n. 11 (citing *North Carolina v. Temple*, 134 U.S. 22, 10 S.Ct. 509, 33 L.Ed. 849 (1890)). *See also Hawaii v. Gordon, supra.* The relief sought by New Mexico would, in our view, require affirmative action by the sovereign or the disposition of sovereign property. New Mexico seeks to change in a significant manner the Secretary's methods of calculating the windfall tax and state royalties; this change would clearly reduce amounts already collected in the Treasury pursuant to the windfall profits tax[2] and require the payment of substantial sums to New Mexico. Thus, as a practical matter, the "essential nature and effect of the proceeding" is such "that the judgment sought would expend itself on the public treasury or domain, or interfere with the public administration." *Land v. Dollar*, 330 U.S. 731, 738, 67 S.Ct. 1009, 1012, 91 L.Ed. 1209 (1947). *See also Dugan v. Rank*, 372 U.S. 609, 620, 83 S.Ct. 999, 1006, 10 L.Ed.2d 15 (1963); *Mine Safety Co. v. Forrestal*, 326 U.S. 371, 375, 66 S.Ct. 219, 221, 90 L.Ed. 140 (1945).

Having concluded that New Mexico's suit is directed against the United States, we must determine whether the United States has consented to such suits in federal district court. *See United States v. Sherwood*, 312 U.S. 584, 586, 61 S.Ct. 767, 769, 85 L.Ed. 1058 (1941). The district

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[2]In its complaint New Mexico noted that the Treasury had collected $3,255,000 in federal royalties from federal lands in New Mexico over a five-month period in 1980. Reducing the taxable royalties derived from public lands located in New Mexico by 50% for this five-month period alone would significantly decrease federal revenues, not to mention the dramatic national impact of such a change when considering its future application to all federal lands.

court, as has been mentioned, based its finding of jurisdiction upon 28 U.S.C. § 1331, and the waivers of sovereign immunity found in 5 U.S.C. § 702 (the Administrative Procedures Act), and 28 U.S.C. §§ 1361, 2201 (federal mandamus and declaratory judgment). While 28 U.S.C. § 1331 grants to the district court broad subject matter jurisdiction over all civil actions arising under the Constitution, laws, or treaties of the United States, that section does not include a general waiver of sovereign immunity by the United States. *See B.K. Instrument, Inc. v. United States*, 715 F.2d 713, 724 (2d Cir.1983). We must therefore look elsewhere in order to examine the extent to which the United States has consented to suit in district court.

Section 702 of the Administrative Procedure Act contains a limited waiver of the United States' sovereign immunity. That section reads in pertinent part:

> A person suffering legal wrong because of agency action . . . is entitled to judicial review thereof. An action . . . *seeking relief other than money damages* . . . shall not be dismissed . . . on the ground that it is against the United States.

Thus, § 702 has been construed as granting the United States' consent to suit in cases involving agency action, subject however, to the proviso that the action is not one for "money damages."

New Mexico contends, and the district court held, that the present action is not one for "money damages" and that § 702 thus provides the necessary consent to suit. In reaching this conclusion, the district court reasoned as follows:

> The State of New Mexico has requested the specific relief of one-half of those royalties received from crude

> oil production from federal lands within New Mexico which were used by the United States to pay the windfall profits tax. The fact that the requested relief is for specific monies held by the Treasury does not mean that the requested relief is for money damages. Damages are a sum of money used as substitutionary relief. Such relief is given to the plaintiff to substitute for a suffered loss which may not have been originally a monetary loss. Dobbs, *Handbook of the Law of Remedies*, 135, (1973). Specific relief, on the other hand, is an attempt to give back to the plaintiff that which he actually lost, not a sum measured by the amount of the loss, but the loss itself. Dobbs, at 135.... This action seeks specific, declaratory and mandamus relief.

New Mexico v. Donald T. Regan, No. 81-452-M Civil, at 6 (D.N.M. June 8, 1983).

We must conclude, however, that the district court failed to ascertain the intent of Congress by engaging in its semantic discussion of the meaning of the word "damages."[3] Section 702 expressly states: "Nothing herein ...

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[3]We note that the legislative history behind § 702 supports a broader view of the term "damages" than that held by the district court. For example, House Report 94-1656 states:

> The first of the additional sentences provides that claims challenging official action or nonaction, and seeking relief other than money damages, should not be barred by sovereign immunity. *The explicit exclusion of monetary relief makes it clear that sovereign immunity is abolished only in actions for specific relief* (injunctions, declaratory judgment, mandatory relief, etc.).

H.R. No. 94-1656, 94th Cong. 2d Sess. (1976), 5 U.S.Code Cong. and Admin.News, 6121, 6131 (emphasis added).

> There is nothing in the legislative history which supports the proposition that the use of the word "damages" was intended by Congress to exclude certain claims for money not falling within

confers authority to grant relief if any other statute that grants consent to suit *expressly* or *impliedly* forbids the relief which is sought." (Emphasis added.) The legislative history supporting § 702 states unequivocally that the provision is to be read in conjunction with other jurisdictional statutes waiving sovereign immunity, and, as an example points out that the "Tucker Act impliedly forbids relief other than the remedy provided by [that] Act." H.R. No. 94-1656 94th Cong. 2d Sess. (1976), 5 U.S. Code Cong. and Admin. News, 6121, 6133. *See also American Science & Engineering, Inc. v. Califano*, 571 F.2d 58, 63 (1st Cir.1978).

The Tucker Act (codified at 28 U.S.C. §§ 1346, 1491) grants concurrent jurisdiction to the district court and the Claims Court (formerly the Court of Claims) over money claims against the United States not exceeding $10,000. For claims against the United States involving amounts greater than $10,000 founded upon the Constitution, Acts of Congress, executive regulations, or contracts, the Act vests *exclusive* jurisdiction with the Claims Court. *Amalgamated Sugar Co. v. Bergland*, *664 F.2d* 818, 823 (10th Cir.1981); *Laguna Hermosa Corp. v. Martin*, 643 F.2d 1376, 1379 (9th Cir.1981); *Chelsea Community Hospital v. Michigan Blue Cross*, 630 F.2d 1131, 1136 (6th Cir.1980).

Several courts have noted that when the "prime objective" or "essential purpose" of the complaining party is to

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technical common law concepts of "damages." Rather, the history supports the view that § 702 should be read with a practical eye, with the focus upon the effect of the claim — does it involve a claim for money, or does it seek only to effect action? It is solely the latter class of claims which fall within the consent to suit granted by § 702. A contrary view would seemingly run counter to the Tucker Act's express scheme for monetary claims against the United States (discussed *infra* in text at 1322).

obtain money from the federal government (in an amount in excess of $10,000), the Claims Court's exclusive jurisdiction is triggered. *See Alamo Navajo School Board, Inc. v. Andrus 664 F.2d 229, 233* (10th Cir.1981) *cert. denied,* 456 U.S. 963, 102 S.Ct. 2041, 72 L.Ed.2d 487 (1982); *B.K. Instrument, Inc. v. United States, supra,* 715 F.2d at 727; *Bakersfield City Sch.* 628 (9th Cir.1979); *Hoopa Valley Tribe v. United States,* 596 F.2d 435-36 (Ct.Cl.1979). Consequently, the Claims Court's exclusive jurisdiction may not be avoided by framing a complaint in the district court as one seeking injunctive, declaratory, or manadatory relief when, in reality, the thrust of the suit is one seeking money from the United States. *Amalgamated Sugar Co. v. Bergland, supra* at 824; *Chelsea Community Hospital v. Michigan Blue Cross, supra* at 1136; *Laguna Hermosa Corp. v. Martin, supra* at 1379; *Hoopa Valley Tribe v. United States, supra* at 436. Similarly, a plaintiff may not transform a claim for monetary relief into an equitable action simply by asking for an injunction that orders the payment of money. *Jafee v. United States,* 592 F.2d 712, 715(3d Cir.1979) *cert. denied,* 441 U.S. 961, 99 S.Ct. 240[illegible], 60 L.Ed.2d 1066 (1979).

The district court concluded that the Claims Court could not assert jurisdiciton over New Mexico's suit because of the "equitable relief" requested by the state. We disagree. New Mexico's claim for past royalties and prejudgment interest is clearly founded upon provisions of an "Act of Congress" (the Mineral Act), and exceeds the $10,000 jurisdictional limit of the Tucker Act. New Mexico's primary purpose is to fix the government's and not the Secretary's liability; accordingly, we must conclude that the suit is essentially one designed to reach money which the government owns. *See Mine Safety Co. v. Forrestal, supra* 326 U.S. at 375, 66 S.Ct. at 221. This, then, is a claim for money congnizable under the Act. New

Mexico's additional requests for an accounting and declaratory relief are merely incidental and subordinate to the basic suit for money. Although such has not always been the case, the Claims Court may now grant equitable relief as an incident to the award of money in the interest of affording complete justice to the parties. 28 U.S.C. § 1491(a)(3) (1976) (*as amended by* Pub.L. No. 97-164,96 Stat. 25). *See Ellis v. United States,* 610 F.2d 760, 762 (Ct.Cl.1979).

New Mexico argues that the federal mandamus and declaratory judgment statutes (28 U.S.C. §§ 1361, 2201) provide the district court with an alternative basis of jurisdiction. While this argument, standing alone, has merit, we believe that allowing the district court to entertain these equitable claims would be improper in the context of this case. Having concluded that New Mexico's claim is primarily one for money over which the Claims Court possesses exclusive jurisdiction, it would not be in the interest of justice or public policy to allow the district court to determine New Mexico's incidental equitable claims. It is settled that the declaratory judgment statute does not itself confer jurisdiction on a federal court where none otherwise exists. *Amalgamated Sugar Co. v. Bergland, supra* at 822. In addition, several courts have specifically concluded that mandamus is not available in the district court when relief can be granted in the Claims Court. *See, e.g., American Science & Engineering, Inc. v. Califano, supra* at 64; *Carter v. Seamans,* 411 F.2d 767, 774 (5th Cir.1969) *cert. denied,* 397 U.S. 941, 90 S.Ct. 953, 25 L.Ed.2d 121 (1970). This court has similarly noted the general principle that mandamus should not be invoked if adequate alternative relief is available at law. *United States v. West,* 672 F.2d 796, 799 (10th Cir.1982) *cert. denied,* 457 U.S. 1133, 102 S.Ct. 2959, 73 L.Ed.2d 1350 (1982). Finally, as we have previously noted, the Claims

Court does not *lose* jurisdiction when equitable claims are asserted in conjunction with primary claims for money against the United States. Similarly, the district court should not *gain* jurisdiction over what is fundamentally a Tucker Act claim simply because the complaint contains requests for equitable relief. *See Portsmouth Redevelopment & Housing Authority v. Pierce,* 706 F.2d 471, 474 (4th Cir.1983) *cert. denied,* — U.S., —, 104 S.Ct. 392, 78 L.Ed.2d 336 (1983).

We must conclude, therefore, that the trial court lacked jurisdiction to enter summary judgment in favor of new Mexico. We need not discuss the remaining issues raised by the appellant.

We direct that this case be transferred to the United States Claims Court for adjudication on the merits "in the interest of justice" rather than dismissing the suit.[4] *See Keller v. Merit Systems Protection Board,* 679 F.2d 220, 223 (11th Cir.1982). *Accord, Dr. John T. MacDonald Foundation v. Califano,* 571 F.2d 328, 332 (5th Cir.1978) (en banc), *cert. denied,* 439 U.S. 893, 99 S.Ct. 250, 58 L.Ed.2d 238 (1978).

The case is transferred to the United States Claims Court pursuant to 28 U.S.C. § 1631.

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[4]28 U.S.C. § 1631 provides:
Whenever a civil action is filed in a court as defined in section 610 of this title [28 U.S.C. § 610] or an appeal, including a petition for review of adminstrative action, is noticed for or filed with such a court and that court finds that there is a want of jurisdiction, the court shall, if it is in the interest of justice, transfer such action or appeal to any other such court in which the action or appeal could have been brought at the time it was filed or noticed, and the action or appeal shall proceed as if it had been filed or noticed for the court to which it is transferred on the date upon which it was actually filed or noticed for the court from which it is transferred.

STATEMENT PURSUANT TO RULE 28.1

The following are the parent companies, subsidiaries (except wholly owned subsidiaries) and affiliates of petitioner TENNECO WEST, INC., a Delaware corporation:

TENNECO, INC., a Delaware corporation

TENNECO CORPORATION, a Delaware corporation

TENNECO OIL COMPANY, a Delaware corporation

KERN COUNTY LAND COMPANY, a Delaware corporation

KERN RIVER CANAL AND IRRIGATING COMPANY, a California corporation

KERN ISLAND WATER COMPANY, a California corporation